COMPARATIVE PERFORMANCE BETWEEN ISLAMIC AND CONVENTIONAL EQUITY FUNDS IN MALAYSIA

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ABSTRAK

Tesis ini mengkaji hubungan antara dana ekuiti Islamik dan dana ekuiti konvensional bagi tempoh Januari 2011 hingga Oktober 2015. Kajian ini dijalankan untuk menyiasat samada prestasi kedua-dua unit amanah ini dapat mencapai prestasi yang lebih tinggi berbanding penanda aras pasaran. Indeks Shariah Emas Bursa Malaysia (FBMEMAS) dijadikan sebagai penanda aras pasaran bagi dana ekuiti Islamik dan Indeks Komposit Bursa Malaysia Kuala Lumpur (FBMKLCI) dijadikan sebagai penanda aras pasaran bagi dana ekuiti konvensional. Sebanyak lapan belas sampel keseluruhan bagi dana ekuiti Islamik dan tiga puluh dua dana ekuiti konvensional dikaji dengan menggunakan tiga prestasi pengukur iaitu indeks Treynor, Sharpe dan Jensen. Nilai mingguan bagi Nilai Aset Bersih untuk dana ekuiti Islamik dan dana ekuiti konvensional diperoleh dari pangkalan data Bloomberg.

Keputusan menunjukkan bahawa keuntungan purata dana ekuiti konvensional adalah lebih tinggi berbanding dana ekuiti Islamik. Walau bagaimanapun, apabila perbandingan kepada penanda aras pasaran dibuat, dana ekuiti Islamik menunjukkan pulangan yang lebih tinggi daripada penanda aras pasaran Indeks Shariah manakala dana ekuiti konvensional menunjukkan prestasi pulangan rendah daripada penanda aras pasaran Indeks Komposit. Dana ekuiti konvensional juga memiliki risiko sisihan piawai yang lebih tinggi berbanding dana ekuiti Islamik yang menunjukkan dana ekuiti konvensional adalah lebih berisiko daripada dana ekuiti Islamik. Tambahan, analisa risiko pasaran menunjukkan dana ekuiti Islamik mempunyai nilai beta yang rendah berbanding dana ekuiti konvensional dan ini menunjukkan dana ekuiti Islamik kurang sensitif kepada perubahan pasaran. Tesis ini boleh dikaji dangan lebih mendalam menggunakan sampel yang lebih banyak dan ciri-ciri yang lain manakala prestasi boleh diukur dengan menggunakan prestasi pengukur selain prestasi pengukur indeks, Sharpe, Treynor dan Jensen.

Katakunci: Unit Amanah, Dana Ekuiti Islamik, Dana Ekuiti Konvensional

ABSTRACT

This study examines the relationship between Islamic and conventional equity funds for the period of January 2011 to December 2015. The performances of both types of funds are then compared to the market benchmark to determine whether they outperformed their respective market benchmark. The FTSE Bursa Malaysia EMAS Index (FBMEMAS) is used as the market benchmark for Islamic equity funds and FTSE Bursa Malaysia index (FBMKLCI) is used as the market benchmark for conventional equity funds. A total of 18 Islamic equity funds and 32 conventional equity funds are evaluated by using three performance measures namely Treynor index, Sharpe index and Jensen alpha. The weekly Net Asset Value (NAV) of the Islamic and conventional equity funds, the market benchmark of FBMEMAS and FBMKLCI were obtained from the Bloomberg database.

The results indicate that the average returns of conventional equity funds are higher than the Islamic equity funds. Nevertheless, when compared against their respective benchmark, Islamic equity funds performed better than its Shariah benchmark while conventional underperform its composite benchmark. Conventional equity funds also have higher standard deviation than Islamic equity funds which implied that conventional equity funds are more risky than Islamic equity funds. Additionally, systematic risk analysis shows that Islamic equity funds have lower beta value than conventional equity funds; hence it shows that Islamic equity funds are less sensitive to the changes in the market. This study could be further investigated in a bigger sample and characteristics while performance can be measured using other technique than Sharpe index, Treynor index and Jensen alpha.

Keywords: Unit Trust, Islamic Equity Fund, Conventional Equity Fund

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INTRODUCTION

1.1 Background of the Study

A unit trust fund is an investment fund that is competently managed by a fund manager, which accumulates the capitals from single investors or institutional investors with similar investment objectives. The funds are long-term investment products, which matched to individual investors who want potential long-term capital growth and are capable to bear the short-term's prices volatility. With the large sum of capital, the fund administrator will invest in a variety of assets such spreading the capital into equity market, money market, fixed income, properties or others according to the investment objectives of the fund, which may not be accessible to an individual investor. [1]Direct investments in specific asset class require quite a huge sum of capital that normally outside the affordability of an individual. But as a group, these categories of investments can become available to them; in which the average, a preliminary investment in unit trusts can begin from as little as RM500[2]. The nature of the fund, the investment strategy and the objectives will be the basis for the fund's portfolio type. For example, an equity fund offers the depositors with availability to the equity market and a possibly earn capital gain and dividend income.

The first asset management company in Malaysia called the Malayan Unit Trust Ltd. was introduced by a number of Australian investors in 1959. Throughout the year of 1959 -1979s, this industry was categorised as a slow growing in unit's trades and a lack of public awareness of the new investment vehicles. Over the period, there were

[1] https://en.wikipedia.org/wiki/Unit_trust
[2] www.maybank2u.com.my (Investment Guide: Unit trusts)

only five management companies with a total of 18 funds being introduced in which the five companies are PMB Investment Bhd, MIDF Amanah Asset Management Bhd, AmInvestment Services Bhd, Amanah Saham Nasional Bhd (ASNB) and BIMB Investment Management Berhad. A number of parties regulated this industry including Bank Negara Malaysia, the Ministry of Domestic Trade and Consumer Affairs, the Registrar of Companies and the Public Trustee of Malaysia.

During the years 1970s, it was the emergence of state government sponsored fund known as National Unit Trust Berhad (NUTB) or Skim Amanah Saham Nasional (ASN) by Amanah Saham Nasional Bhd (ASNB), the unit trust company of Permodalan Nasional Berhad (PNB). The main intention of NUTB's establishment was to mobilize the individual Bumiputras into savings through the promotion, advertising and selling of the proposed national unit trust. Furthermore, the launching of the fund was to help develop the indigenous Malays' economic and social position. On 1 March 1993, the Securities Commission was established, combined with the execution of the Securities Commission (Unit Trust Scheme) Regulations in 1996 and broad advertising approaches adopted by Permodalan Nasional Berhad (PNB) to promote ASN, showed important responsibility in making unit trusts household products in Malaysia.[3]

Its development was very encouraging as shown in Figure 1.1. As at June 2016, the industry recorded 35 asset management companies that manage a total of 640 unit trust funds with a total approved fund size of RM472.426 billion units in Malaysia. When it was first launched in 1993, there were only 174 Islamic unit trust funds representing approximately one-fourth of the 640 units launched funds in this country with more than RM349 billions of net asset value (NAV) from 18,365,246

[3] http://www.fimm.com.my

accountholders. The net asset value of unit trust funds represents 21.05% of the total market capitalisation of Bursa Malaysia (Securities Commission, 2016).

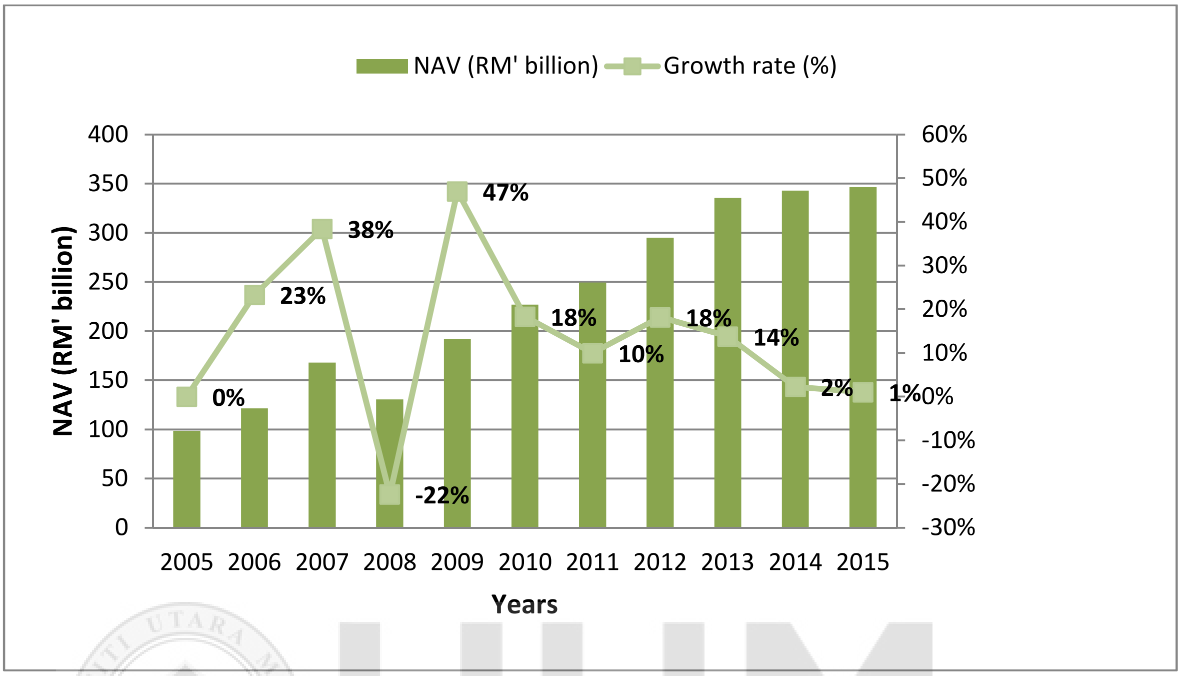

Figure 1.1
Net asset value of the Malaysian unit trust industry (2005-2015)

Figure 1.1 shows the sum of net asset value of the 37 fund management companies related to unit trust fund in Malaysia from 2005 to 2015.[4] Total net asset value increased dramatically from RM98.485 billion in 2005 to RM346.578 billion by the end of 2015. The asset allocation of unit trust funds represents 27.54% equities, 11.09% bonds, 20.96% money market instruments, and 26.83% Islamic unit trust funds.[5]

Islamic equity funds are one of the fastest funds to grow when compared to other funds in international financial system and in Islamic financial industry. In detail, the Islamic funds has increased about 830 funds in 12 years period which is to 1,030 funds in 2015 from 200 funds in 2003, which comprises a variety of Islamic mutual

[4] https://www.sc.com.my/data-statistics/unit-trust-funds-in-malaysia-summary-of-statistics/
[5] http://www.fimm.com.my/resources/publications/annual-report

funds (ISRA & Zawya, 2015). Correspondingly, the value of assets which being managed as Islamic funds has tripled to USD60.2 billion in 2015 from USD20 billion in 2003. From the asset values, 40% of the values are from Islamic equity funds followed by Sukuk with 16%, real estate and private equity by 13% and the others are commodities, cash, and other type of funds. Middle East/Africa, North America, Asia Pacific and Europe are among the regions in which these funds are concentrated. Middle East and Asia-Pacific region with Saudi Arabia being a key player for the Islamic funds, contributing 41% of the global Islamic asset under management in 3Q 2015.[6] In term of number of Islamic funds, Saudi Arabia has 18% of the total market share.

A survey by Ernst & Young found that Saudi investors consider Shariah-compliant offering as a preferable investment compared to conventional investment and are willing to sacrifice lower returns for the former investment option. [7] The key jurisdiction of Islamic funds industry for Asia is Malaysia, Pakistan and Indonesia. Malaysia contributes the leading number of global Islamic funds with a market share of 24% and the second biggest Islamic asset under management, representing a total of 28% market share as per 3Q 2015.[8] The total value of Islamic asset under management in Malaysia as per June 2015 was RM117.40 billion or approximately USD27.20 billion, representing 17.9% market share of the total asset under management industry in Malaysia. In particular, the country has launched 190 Islamic funds with the total net asset value (NAV) of RM48.99 billion or USD11.35 billion, representing 13.8% of the total unit trust fund industry as per June 2015.

[6] Thomson Reuters, 2015
[7] Industry Interview, Ernst and Young Analysis, 2014
[8] ISRA' & Zawya, 30 September 2015

The country also launched 76 Islamic wholesale funds (WF) with the total NAV of RM23.48 billion or USD5.44 billion, contributing to 31.3% of the total WF industry. Furthermore, Malaysia has also launched 18 Islamic private retirement scheme (PRS) with the total NAV of RM258.10 billion or USD59.8 billion, accounting for 28.7% of total PRS industry in Malaysia in 2015. As for Exchange Trade Fund (ETF), the country introduced three Islamic ETF with the market capitalization of RM0.32 billion or USD0.07 billion, representing a total market share of 30.2%. Finally, Malaysia also launched 3 Islamic Real Estate Investment Trust (REIT) which are Axis Real Estate Investment Trust, Al-Salam Real Estate Investment Trust and KLCC Real Estate Investment Trust with the market capitalization at RM15.35 billion or USD3.55 billion, contributing 42.1% to the total REITs industry in Malaysia in 2015.[9] It is also noteworthy to inform that more than one third of new Islamic funds are launched yearly in Malaysia since 2000 onward.[10] For that reason, the country is regarded as one of the most active jurisdictions in introducing new Islamic product to the market.

The Malaysian equity market is pretty huge contrast to the size of its financial system. As at 31 December 2015, the total market capitalization of Bursa Malaysia stood at RM1.67 trillion. This is some 167% above Malaysia's gross domestic product (GDP) in 2014. The growth in equity market shows an increased to RM1.70 trillion in 2015 as compared to RM717.5 billion in 2000. Shariah-complaint's market capitalization reached RM1.09 trillion in 2015, which cover up 64.1% of the total market capitalization. As a percentage of GDP, Malaysia's equity market capitalisation has seen a strong growth of 11.1% per annum which has consistently outpaced the economy (Securities Commission, 2015).

[9] Bloomberg, 2015
[10] SC Annual Report, 2014

Given the improvement in Malaysian equity market, the total net asset value of equity unit trust funds remains uptrend over the period 2004 to 2010, except in 2008 driven by strong growth in equity market. Over the period, the new funds raised through conventional equity funds exceeded the amount of new issues for Islamic equity funds. The number of new equity funds launched declined in 2007 until 2009 as asset management companies consider the benefit of diversifying funds into other types of funds including bond funds, money market funds, REITs funds, and index funds to take advantage on the volatility of equity market. Year 2015 recorded the ninth consecutive year of firm growth in Islamic funds with total NAV stood at RM69.5 billion as at end of 2015, a raise of 10.9% as compared to 2014's NAV of RM62.7 billion, whereas the NAV for conventional equity funds recorded an all year high in NAV of RM40.7 billion, an increase of RM3.8 billion as compared to 2014's NAV of RM36.9 billion.

Due to the increase of investment in Islamic equity unit trust funds, it creates an opportunity for this study to be carried out. Despite the sharp rise in total net assets of equity funds, very few studies on equity funds are carried out to look into their comparative performance. Previous studies on comparative performance between Islamic equity fund and conventional funds include Zaher and Hassan (2001), Hayat (2006), Taib and Isa (2007) and Hoepner, Rammal and Rezec (2009).

Due to above reasons, this study observes the comparative performance between Islamic and conventional equity funds in Malaysia. Both types of funds are compared to find out which performs better in the Malaysian capital market. It is hypothesized that different types of unit trust fund lead to different outcomes in terms of risk and return.

1.2 Islamic Equity Funds

The Islamic equity funds (IEFs) emphasis mostly on the investments in portfolios of 'halal' investment. Thus, these 'halal' funds will eliminate those businesses which associated to the conventional products or services, hedging in foreign exchange, financial services and insurance that generates their income from interest, alcoholic beverages, non-halal food products, casinos and gambling. Due to the restrictions on usury, IEFs ability to invest in areas such as financial instruments and fixed-income securities are limited. [11]To hedge the risk against inflation, IEFs tend to make a long-term equity investment as they cannot involve in bonds and other interest accrual securities. Islamic prohibited as they signify components that are banned by Allah and the adverse effect of such instruments on human beings. Returns earned from the funds are generated mostly through the capital gains from the increment of share price. Apart from that, the returns also earned from the company's dividends distributions.[12] IEFs are managed in a manner that complies with Shariah law and restrictions, so that investors that contribute their money to the investment can earned "halal" profits. The validity of the units, shares or certificates issued in the fund depends on two conditions. The first one is the return will be given to the investors by a pro-rated profit and not by a fixed return tied up with the fund's face value. Hence, both the principal and the rate of profit cannot be assured. Therefore, the investors must have the correct understanding that the return on their investment is from actual profit or loss suffered by the fund. When the funds produce a large profit, the investor will earn the same increase in proportion. On the contrary, if the funds incur losses, the investors will bear it too, unless the loss is generated by the carelessness or misconduct, in which the fund management will be liable to

[11] http://www.saturna.com/amana/halal_investing.shtml
[12] http://www.financepractitioner.com/capital-markets-checklists/islamic-equity-funds

compensate it. Second, the capital must be invested in a business that within the Shariah limitations.[13]Therefore, IEFs have a clear benefit to Muslims investors, who can invest their money safe in the knowledge that the fund will not compromise any of their religious values. If the fund has accidentally made profits from investment in prohibited activities, the fund will liquidate the investments. The profit gain from it will then be donated to charities.

Further than following the similar criteria of conventional unit trusts as explained in the Securities Commission's Guidelines on Unit Trust Funds (1997), the IEFs have to meet the principles as advised by the Securities Commission's Shariah Advisory Council (SAC). For example, the IEFs are required to appoint Shariah trustees who must be approved and registered by the Securities Commission (SC). The maintenance of IEF's accounts is encouraged to maintain with Islamic financial institutions. Nevertheless, it is permissible to have accounts in other financial institutions provided they are maintained in manner within Shariah values. For investment in listed securities on Bursa Malaysia, the investments are restricted only in securities listed on the SAC's list of Shariah-compliant securities in which the list is updated twice a year (May and November). Stock screening involves both quantitative and qualitative assessments. Quantitative assessment gauge the contribution from Shariah non-compliant activities (computed and compared with group revenue and the group profit before tax) must be below predetermined thresholds and the financial ratio of Shariah non-compliant cash and debt must be below a predetermined percentage of total assets (i.e. 33%). On the other hand, Qualitative assessments assess public perception and image of the company.[14] In

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[13] https://www.albalagh.net/Islamic_economics/finance.shtml
[14] https://www.sc.com.my/revised-screening-methodology/

addition, for investment in unlisted securities, the fund manager should pursue the SAC's methodology of the listed securities' status.

In the context of Islamic fund, investors can monitor the fund's performance fluctuations by observing the Shariah index. In Malaysia, Kuala Lumpur Shariah Index (KLSI) which was launched on 17 April 1999 was replaced by FTSE Bursa Malaysia EMAS Shariah on 1 November 2007. Not only that, Bursa Malaysia also cooperated with Dow Jones Market Asia to establish the other relevant indices. The main reason of the replacement is to provide a more globally relevant trading foundation for both domestic and foreign investors to base their investment analyses and decisions, increasing its appeal to international investors.[15]

Chief Executive Officer of Federation of Investment Managers Malaysia (FIMM), Mr. Lee Siew Hoong believed that the similarity with the Socially Responsible Investing (SRI) is a most important characteristic of Islamic funds that give value added to investors who invest to this asset. The underlying investment of the funds has to fulfill the selection criteria of ethical investing and thus make Islamic funds more attracted to the depositors that searching for an investment tools that adopt a fair and decent investing philosophy.[16] In facts, in developed countries like the U.S., the approximated value of total assets that managed in Islamic funds is worth about USD4.17 trillion in 2012.

Pew Research Center (2011) stated that, the global Muslim population is expected to increase by 35% for the next 20 years, from 1.6 billion to 2.2 billion by 2030.[17] The

[15] BursaBytes, Issue 4 Vol 2 JAN 2011
[16] https://www.fimm.com.my/wp-content/uploads/latest-news/THE-OPPORTUNITIES-AND-CHALLENGES-FACED-BY-THE-ISLAMIC-UNIT-TRUST-INDUSTRY-IN-MALAYSIA.pdf.
[17] www.pewresearch.org/daily-number/global-muslim-population-2030/

largest future growth by 2020 will be happening in Americas. Therefore, assets management companies should remarks of these ongoing trends because it potentially offers opportunity to Shariah compliant an opportunity as substitute to conventional funds. International Finance Corporation (2009) based in Middle East and North Africa region stated that 75% of the population is below the age of 30, and approximately 27% are below the age of 15. [18]This shows at least 7 out of 10 people in the region are just starting out their careers, or still in school. This trend on aging population is the same with other part of the regions, for instance in Asia-Pacific and West Asia. So, it is possible to assume that there are going to be a general demand for Shariah-compliant products in the Muslim global market. Not solely rely on Halal based products but also in Islamic financial product. This scenario attracts those non-Muslim to Islamic equities, so the benefits go beyond the religious.

In US alone, the growth in socially responsibly investment has tremendously increase by the end of 2010, with assets under management to be estimate USD3 trillion. Shariah-compliant funds are invested based on Shariah principles that restrained in investment in Haram (illegal) business. This principle has attracted those non-Muslims investors that shares same values with the Muslims.

Given the strong effort by the Malaysian government in the fund management industry, include the incorporate measure on investment scheme such EPF Members' Investment Scheme of unit trust to public where on 1 April 2016, FIMM announced revised list of 234 active unit trust funds from 23 Fund Management Institutions (FMI) approved under the EPF-MIS (Member Investment Scheme) in November 1996 which permit accountholder to withdraw a fraction of their savings in Account

[18] http://www.catalyst.org/knowledge/generations-demographic-trends-population-and-workforce

1[19] for investments in approved unit trust funds through FMIs, that give them the possibility to increase their retirement savings. The list of EPF Approved Funds meets the standard criteria, such as have the investment mandate of not exceeding 30% in overseas assets as well as consistency in profit among the benchmark and peers, also having at least three-year track records. Out of the 234 unit trusts, 71 were Islamic equity fund which account for 30% of it.

1.3 Conventional Equity Funds

Conventional equity funds are the most regular type of unit trust fund. Majority of its assets are commonly held in equities or securities of listed companies. There is a wide number of this fund being offered in the market, consists of funds with higher risk, higher returns to funds with lower risk, lower returns. For conventional equity funds, fund managers also invest a portion of the assets into the money market, which comprises of risk free investments apart from investing solely in the equity market.

Within the equity unit trust funds industry, such funds are holding the largest contributor to asset allocation of the asset management companies. Over the last 10 years as shown in Figure 1.2, the Malaysian equity unit trust funds shows a gradual increase except in 2008 where the net asset value of such funds dropped by approximately 42% to RM15.0 billion from RM25.7 billion in 2007. This is due to stock market downturn that dragged the funds' poor performance. In 2015, equity funds recorded NAV of RM44.2 billion, an increase of RM4.3 billion as compared to 2014.

[19] http://www.kwsp.gov.my

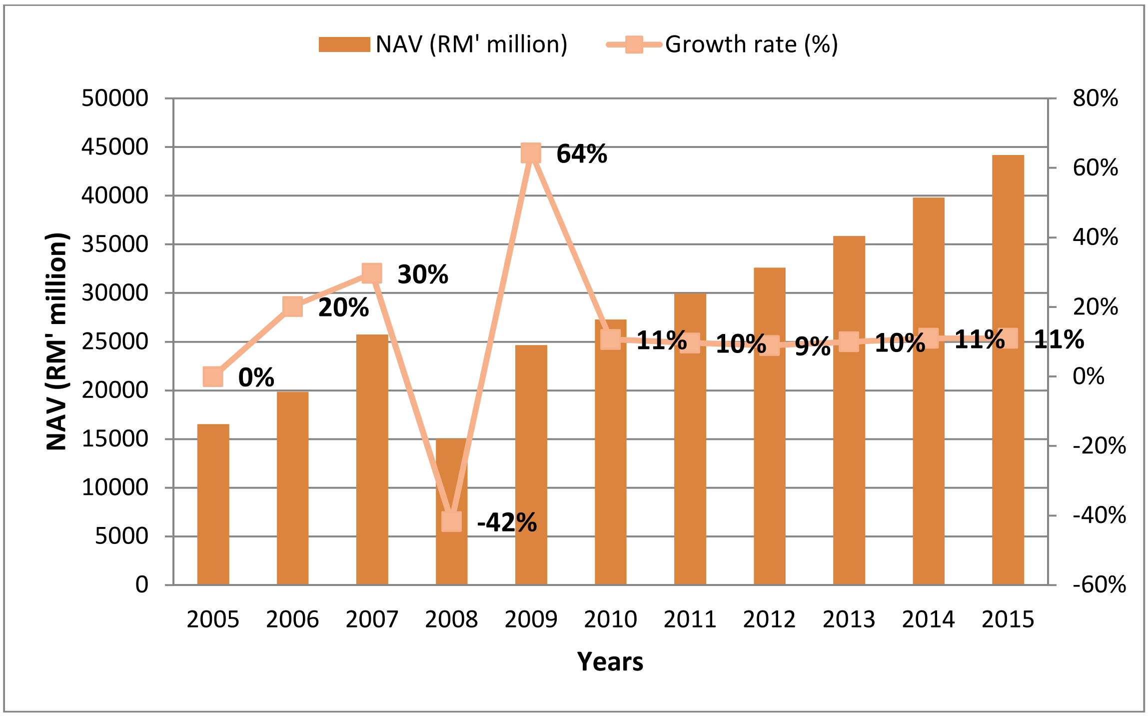

Figure 1.2
Net asset value of the Malaysian equity unit trust funds (2005-2015)
Source: Federation of Investment Managers Malaysia (FIMM) Annual Reports

Investment in equity funds in Malaysia can be categorised into value and growth style funds. Generally equity unit trust funds are similar to stock funds, invested primarily in equities or securities listed on Bursa Malaysia stock exchange. These equity funds concentrate on different types of funds depending on the nature of the funds namely blue chip funds, aggressive growth funds, small cap funds, growth funds, income and growth funds, and index funds. In addition, growth equity unit trust funds aim to get a stable long-term capital gain from a larger capitalisation investment with diversified portfolio.

Value equity unit trust funds refer to income and growth funds. Such funds provide current income mostly generated from the dividends received and the long term growth via capital appreciation. The primary objective of these funds is to offer stable income stream and high dividend yield that is likely more than the fixed deposit rates. In addition, these funds focus on income-generated securities namely bonds, utilities stocks, money market instruments and rental properties. For most value equity funds, 70% of the investment portfolios are invested in the equity market and the remaining 30% in fixed income instruments. It is designed for conservative investors who look for higher returns than fixed deposits but are averse to take higher risks linked with high equity exposure.[20]

1.4 Problem Statement

The fund management industry in Malaysia has been developing since the last decade. This can be seen as evidenced by the increase in the net asset value (NAV) of the funds. In the year 2000, the NAV has been increasing from RM43.3 billion to RM346.58 billion in 2015 which is 12% growth rate annually. Islamic unit trusts shows a high growing despite its smaller base, the NAV increased to RM69.5 billion in 2015 as compared of RM1.7 billion NAV value in 2000. In April 2011, Securities Commission launched the Capital Market Masterplan 2 (CMP 2) and it is estimated that the total NAV for the whole unit trust industry will reach RM827.9 billion in 2020 whilst the total NAV for Islamic unit trusts alone is RM158 billion in 2020. The main outline of CMP2 blueprint is to uphold the Islamic unit trusts as a key pillar for the unit trust industry. Even though there is a pleasant development of Islamic unit trust industry, professional believed the expansion rate is still fairly slow

[20] Eastspring Investments' Master Prospectus (2015)

as compared to other investment products. It is because as at June 2011, the NAV of Islamic unit trust funds somewhat only 10% of the total unit trust industry NAV.[21]

One could argue that this type of investment can be inclined to have lower profits than predominant conventional unit trust funds because of restrictions in assets selection. However, the earlier shows mixed findings on the performance of the Islamic unit trust in Malaysia. These findings may be due to the fact that it takes into account all types of Islamic fund which include balance fund, index fund, fixed income fund and equity fund in evaluating the performance. In order for Islamic unit trust fund to be accepted by public, the participants collectively agreed that the funds should at least do well or outperform the Shariah index

Globally, an approximately USD1 trillion Islamic funds under management, and the quantity is estimated to increase speedily looking at the current growth rate of the fund industry. Islamic funds have shown an average growth of 9.55% per annum for the past five years. Conventional mutual funds play an essential component of the Islamic financial landscape in the developed markets. It is projected that Islamic financial market will follow a similar pathways the developed market thus the growth of Islamic finance segment and Shariah-compliant asset class will share the same level as the developed market. In addition to that, future of Islamic funds industry is driven by the exciting development of Islamic banking and finance as part of natural progression and evolution of the global Islamic financial industry. Global Islamic banking deposits recorded an annual growth of 19.5% from 2014 to 2015. Based on conservative position, it is projected that Islamic banking deposit will grow

[21] Keynote speech for the on July 11, 2011 at the Sime Darby Convention Centre was delivered by En. ZainalIzlan, the Executive Director of the Islamic Capital Market of the SC and En. Mohd.Radzuan, the Deputy General Manager and Head of Islamic Capital Market Department of the SC

8% per annum for the next five year. Similar growth is also expected for Islamic funds as part of Islamic finance segment.[22]Comparable movement is being observed in the Islamic unit trust industry in Malaysia. In June 2016, Islamic based funds worth 200 funds from the total of 640 approved funds in Malaysia. Compared with the total of Islamic-based funds sixteen years ago which worth only 17 Islamic funds from the total 127 approved funds at the end of the year 2000.

Unit trust agent and financial planners show distinguished roles with the introduction of Private Retirement Scheme (PRS) in July 2011.It further diversities and add value to the domestic saving intermediaries and at the same time broaden the role of the investment management industry. With one-fourth of the funds that has been approved by PRS funds together with the Islamic funds, the private pension industry was expected to increase the distinction of Shariah-compliant instruments available in our capital market This has given Malaysia's the leading roles in Islamic finances and this will to be the leading Islamic fund and wealth management hub. In order to pursuit this, more efforts needed to expand the range of Islamic investment but also to reach wider group of investors and market participants. PRS indicated tremendously growth of 62.5% in 2015 with NAV stood at RM1.2 billion compared to RM0.72 billion in 2014. The fund comprised 34 core funds and 16 noncore fund where 30 were conventional funds and 20 were Islamic funds.[23]

Equity funds were the most preferred funds by investors, with net sales of RM15.9 billion in 2015.[24]Given the importance of unit trust funds to Malaysian investors, it is essential to evaluate their relative performance of equity fund. This is especially

[22] BNM's Monthly Statistical Bulletin (2015)
[23] http://www.fimm.com.my/resources/publications/annual-report
[24] Unit Trust Review: Malaysian unit trust industry, sizzling or simmering? By Amanah Mutual Berhad on Jan 4th, 2016

true as there is lack of comprehensive studies on the evaluation of Islamic and conventional equity funds in Malaysia. The evidence from the previous studies on unit trust performance focused on the overall Islamic funds versus conventional funds' performance in which include equity, money market, fixed income, REITs and others. To the researcher's best awareness there is only a few data from the earlier study to focus on comparative analysis between Islamic and conventional equity unit trust specifically invested in Malaysia. Therefore, this study will add valuable contribution to the literature on the subject.

Due to above reasons and despite the tremendous growth of Islamic unit trust development, there are indeed concerned to examine the comparative performance of the funds in terms of their risk and returns. Against this backdrop, this study is carried out to explore the performance of those funds whether they are doing better or not compared to the market benchmark.

1.5 Research Questions

In this study, the main research questions are:

1. Is there a difference in the performance of risk and return between Islamic and conventional equity funds?
2. Do Islamic and conventional equity funds outperform or underperform the FBMEMAS and FBMKLCI's market benchmark?

1.6 Research Objectives

1. To examine whether there is a difference in risk and return performance between Islamic and conventional equity funds.
2. To compare Islamic and conventional equity funds performance against the FBMEMAS and FBMKLCI's market benchmark.

1.7 Significance of the Study

This study is done to benefit the investors as the findings would provide insight in their decision making regarding the investment, particularly in the choice of either Islamic equity funds or conventional equity funds.

To other researcher, this study will be a valuable reference to other researchers who want to carry a study on the subject of the performance of equity funds in Malaysia. A number of areas in this study can be further examined by other researchers and this study offers an opportunity to other researchers to increase their knowledge and facts regarding the funds. To finance students, this study will be useful for finance students in added new data and information about the fund's performance and the differences in the performance between Islamic and conventional equity funds in Malaysia. They can utilize this study as their references in their portfolio management and mutual fund in Malaysia. To fund managers, such as Kumpulan Wang Persaraan (KWAP), Employee Provident Fund (EPF), Lembaga Tabung Haji (LTH), Permodalan Nasional Bhd (PNB) and also the insurance companies; the findings could give them some view and judgment on their decision making process of which funds will they choose to invest in. It is likely that there would be an adjustment on their portfolio investment policies. To the regulators, namely Bursa Malaysia and Securities Commission, and Bank Negara Malaysia, a comparative analysis of Islamic and conventional equity funds' performance might assist in improving and strengthening the unit trust funds industries. In addition, it is hoped that the study would contribute to the body of knowledge and existing literature on unit trust funds.

1.8 Organization of the Study

The next chapter covers the review of significant literature in this study. This is followed by research methodology in Chapter 3. Chapter 4 presents the results and analysis based on the theoretical theories performed. Subsequently, Chapter 5 concludes and summarizes the thesis.

CHAPTER 2

LITERATURE REVIEW

2.1 Introduction

This chapter illustrate the underlying theory related to this study and empirical evidence on Islamic and conventional equity unit trust funds performance. It begins with a discussion on risk and return of portfolio theory. This is followed by a report from previous studies.

2.2 Portfolio Theory

Harry Markowitz proposed the portfolio theory in 1952. It is based on the variance computation of a portfolio to reduce the total risk as well as to illustrate how to mix asset effectively to form the most efficient portfolio. It explains that some sources of risk connected with individual assets can be removed by holding a proper combination of assets. The portfolio theory's primary starting point is the requirement to assume that depositors are risk averse which basically means that the depositors will reject the investment products with additional risk unless it is accompanied by a higher expected rate of return.

Below are the individual's investment behavior assumed by Harry Markowitz:

- Depositors prefer the investment with the lowest amount of risk with the same level of expected return
- Standard deviation is used by depositors as a risk measurement
- The depositors can calculate the expected return and the probability of the returns of each investment and over a specific time horizon

- The investment's level of risk and return is used as a benchmark for depositors to make decision

This theory proposes that an "efficient frontier" of optimal portfolios is possible to be form in which for a given level of risk, maximum potential expected return. It is believed that looking at one particular shares' risk and return will not be enough. If the depositors invest in several investments products, they can gain the diversification's benefits as it reduce the risk of the portfolio as a whole. This allows the depositors to diversify or eliminate a portion of each security's risk. With additional analysis, given the risk level the subset of portfolios with the highest expected return can be identified.[1]

Each share carries its own risk, which also known as standard deviation from the mean. A portfolio with various different stocks will be less risky than a portfolio that hold only one individual stocks in the portfolio with a condition of the different stocks are not directly related. According to Reilly and Brown (2009), based on a given level of risk investors are capable to construct a portfolios with maximize expected return.

[1] www.investopedia.com

2.3 Markowitz's Efficient Frontier

Markowitz's efficient frontier refers to a set of optimal portfolios that present the maximum expected return for a given amount of risk or the smallest risk for a given level of return (Reilly & Brown, 2009). Markowitz created a structure than can compare and evaluate various investment choices with a mathematical analysis using unsystematic risk statistics. He calculated the expected rate return and expected volatility for each of the investment choices in the portfolio. Below is the graph that shows how the efficient frontier portfolios when plotted. This efficient frontier's main rationale is to earn maximize return while reducing the volatility.

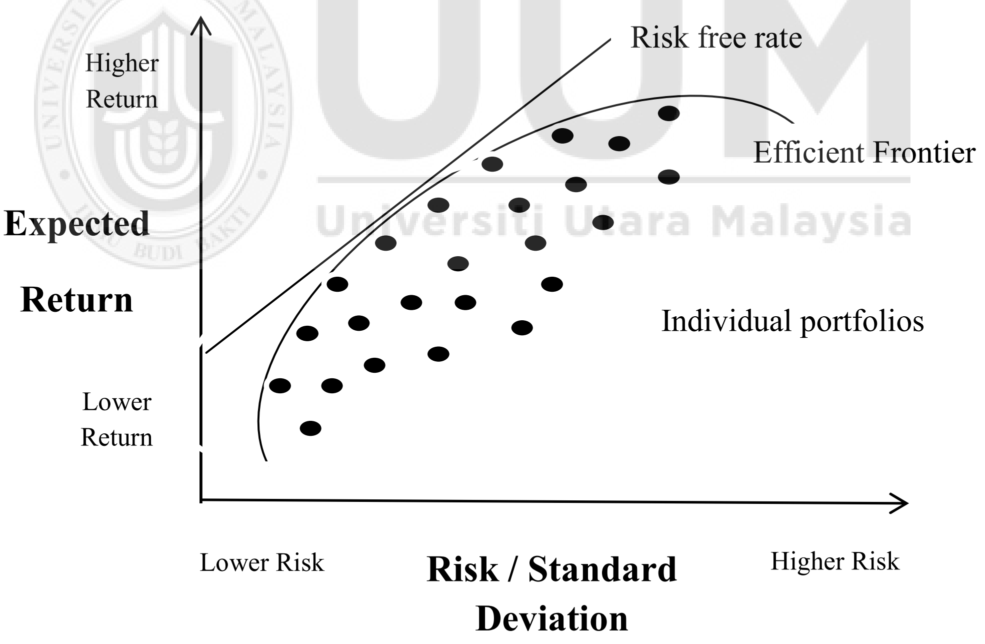

Figure 2.1
Markowitz's Efficient Frontier

When a portfolio offer a higher expected return with lesser or equal amount of risk among other portfolio, that portfolio is believed to be efficient. The upward sloped portion is the efficient frontier if no risk-free asset is available. With a risk-free asset, the straight line is the efficient frontier.[2] Generally, investors yearn for portfolios that contain the best of risks and returns. The selected portfolio varies among investors depending on their utility curve in maximizing their satisfaction. Such decision could be made through efficient frontier where investors have an opportunity to select from a set of risk and return mixture of different portfolios.

2.4 Risk and Return

According to portfolio theory, with a standard return distribution, a risk can be calculated by standard deviation of the return. Most investors would prefer more superior return that carries lesser risk. Additionally, the likelihood to get higher or lower capital gain than the average mean varies on the standard deviation (Ross, Westerfield, & Jaffe, 2010).

Portfolio theory constructs a difference between two types of risks:

- Unsystematic risk. This risk is also known as diversifiable risk. The risk is linked in a security, company or the industry and this risk can be reducing by diversification which is allocating the capital by investing in various assets in different sectors.
- Systematic risk. This risk is also known as market risk or un-diversifiable risk. The risk affects the entire market and investors have to deal with the daily volatility in stock's price as the risk cannot be diversified away.

[2] https://en.wikipedia.org/wiki/Efficient_frontier

The relationship between risk and return is often represented by a trade-off. This trade off in risk return play an important role for investor when they are considering an investment options. In general, higher risk will offer higher return and lower risk will bring smaller return.

2.5 Efficient Market Hypothesis

The efficient market hypothesis (EMH) is an investment theory that specifies it is impossible to "outperform" the stock market. It is because the efficiency in stock market makes the existing shares prices to continuously reflect all the information.

Based on this EMH theory, the share price will be traded at the fair value on the exchange. Thus, it is difficult for the investors to buy or sell their shares for inflated prices. As a result, even with the help of expert in stock selection and market timing, it is still impossible to beat the market, and by purchasing riskier shares is the only way for investors to gain greater return.

There are three forms of the EMH which the first form is the weak-form. This form states that all the past data and information of the shares are fully reflected in share's prices. It is believed that extra returns cannot be achieved using technical analysis. The second form is semi-strong. This form states that all publicly available data and information is fully reflected in shares' prices. It is believed that extra returns cannot be achieved using fundamental analysis. The third form is the strong-form. This form states that on all public and private information is fully reflected in securities prices. It is believed that extra returns are impossible to achieve consistently.

The implication of EMH to the investor is that no investors either individual or institutional investors is capable to outperform the market in consistent by using a common investment approach. Consequently, investors have extra return to gain from active investment strategies by adopting aggressive strategy with the objective to beat the market performance. For the investor who does not wish to beat the market, it is wisely to adopt passive investment approach that still optimized the returns through better asset allocation and diversification method while minimizing the possible taxes and cost related to the investment. In addition, the portfolios choose by the fund manager should follow time horizon and risk profile of the investor.

2.6 Empirical Evidence on the Overall Performance of Unit Trust Funds

Treynor and Mazuy (1966) concentrated on the return of 57 U.S funds from the year 1958 to 1962 and they discovered comparable outcome as Sharpe (1966) that the funds on average cannot beat the market performance. Jensen (1968) examined 115 U.S mutual funds in extended time horizon for 19 years commencing year 1945 through 1964. S&P 5000 were used as a proxy of market performance. He created and used Jensen's Alpha to determine the fund manager's stock selection and price prediction ability. The result supported Sharpe's and Treynor's discoveries that the fund manager is incapable to forecast the share price consistently in buy and hold strategy. Afterward, Moles and Taylor (1977) further upheld those outcomes about Sharpe's. They performed a study on 86 U.S mutual funds in terms of the risk-return performance starting from 1966 until 1975 and discovered nearly in all cases, the fund's performance variables such the fund's size and the share's quantity had a fragile predicting power on the fund's performance.

On the other hand, conflicting result was found in a study carried out by Friend et.al. (1970). Emulating the Sharpe's, the research from the year of 1960 to 1968 showed the mean return of the funds was superior against the benchmark's performance. Diverse outcome has been discovered by Ippolito (1993) after doing statistical evaluation on the funds from the year of 1962 to 1991. He revealed that the funds outperform the market indices. Moreover, he discovered that there is a consistency in return in funds with exclusive of expenses with the fund risk-adjusted performance and the performances are comparable to the indices. Those outcomes support his earlier study of 143 U.S funds from the year of 1965 to 1984 that the funds earned higher rate of return if the funds have higher turnover fees and expense.

The analysis done by Firth (1977) on 72 U.K funds for the year 1965 to 1975 found that the fund managers in the U.K were unable to forecast the share price precisely toward a simple buy and hold strategy and concluded U.K fund managers were poor in predicting the price movement. Bal and Leger (1996) further conducted a study of 92 U.K funds for 18 years commencing 1975 through 1993. By using multiple performance measures such as Jensen alpha, Sharpe index and Treynor index, they found that unadjusted funds exhibit better performance than the market.

Luther et al. (1992) examined the performance of 15 SRI funds in U.K market for the year 1984 until 1990 and they found a weak correlation that the funds will outperform the market index. Moreover, he also documented a bias found on smaller SRI companies. Luther and Matatko (1994) further evaluated 9 SRI funds from the year 1985 through 1992 and supported this small cap bias and they concluded if the funds were compared to a small cap benchmark, it will improve the funds relative performance significantly.

Fletcher (1999) conducted a comparative study on the performance of 85 U.K funds with North American for 11 years starting January 1985 through December 1996. He found no significant evidence that both U. K and North American funds whether individually or on average achieve abnormal returns. Additionally, no correlation is found in the abnormal return and the charges of the funds. Therefore, he believed that both U.K and North American's fund managers displayed about the same skills on managing their funds.

Statman (2000) examined comparable performance between 31 SRI equity funds and 62 unscreened conventional funds from the year 1990 to 1998 by using Jensen's alpha. Domini Social Index and S&P 500 were used as the market indices. Statman found that while socially responsible funds were underperforming relative to both the market indices, its performance is better when compared to the conventional funds with similar size. However, the performance between the two groups of funds was not statistically significant and negative mean were observed for both funds.

Hoepner, Rammal and Rezec (2009) investigated 291 Shariah equity funds from 20 various countries. They extend Carhart's model that can control simultaneously the exposure from the different equity markets of the 20 countries. The test produced results that Shariah equity funds displayed better performance in developed financial markets. Although funds in developed markets outperformed the global benchmark, Western funds with less Islamic assets underperforming the benchmark. The investment styles in Islamic markets show pattern of low debt to equity during bearish time as they avoid investing in high risk assets.

Yaccob, Karim and Khalid (2015) conducted comparative analysis of 5 Islamic with 5 conventional funds for 8 years period from January 2007 to December 2014 in regards of the performance and persistency relative to the benchmark. Jensen alpha Sharpe index, and Treynor index are used as performance measurement. The samples were separated into two sub-periods that is during financial downturn and after financial downturn. The findings showed that during crisis all the funds were outperformed the market benchmark while after crisis showed 3 three Islamic funds and 3 conventional funds outperformed the market benchmark. Moreover, the risk-return characteristics of the conventional funds showed higher value of standard deviation and this indicated that the funds are more risky than Islamic funds.

Bukhari and Azam (2015) performed a study on 224 Islamic funds and 573 socially responsible funds for 9 years period from January 2006 to December 2014 in terms of the risk adjusted performance, market risk (systematic risk), and market volatility. The authors applied Jensen's alpha and Treynor-Mazuy and to measure the funds' performance. The test revealed that while there are several variations in the risk factors of SRIs and IEFs, both funds are associated with lower risks and the fund managers have about the same market timing capability. Furthermore, both funds also underperformed to their relative market benchmark. They concluded that IEFs is an attractive option for risk-averse investors as well as for any fund manager during market crisis and periods of excess volatility due to the fact of its low betas with respect to both Islamic and conventional market indices.

Kusairi et al. (2013) investigated 420 Malaysian funds for 13 years period from January 2000 to June 2012 in regards their monetary environment, characteristics and performance. They used MGSI and KLSE indices as proxies to market benchmark and regression analysis as measurement tool. The sample funds are divided to 4 geographic groups which were into international, domestic, global and Asia Pacific. The monetary environments are separated into expansive monetary environments and restrictive monetary environment. The findings revealed that all the funds excluding Asia Pacific group underperformed the market benchmark. They also found that the geographic fund's performance is strongly influenced by portfolio market benchmarks. Nevertheless, they believed that different benchmark will produce a different effect in the monetary environment. It is also found that the fund managers are bad in market timing in analyzing the market information and achieve abnormal returns.

Suhana et al. (2012) investigated analysis of 4 Islamic funds with 4 conventional funds from January 2005 until December 2009 by using Sharpe, Treynor and Jensen measurement. Islamic fund's performance is then compared towards KLCI benchmark. The study revealed that both type of funds underperform the KLCI benchmark results from Sharpe and Treynor index's results. While Jensen index showed a negative value and this indicated that fund managers having poor selection skill to manage the unit trust funds.

Dewi and Ferdian (2012) conducted an analysis between Malaysia and Indonesia's Islamic funds commencing January 2006 to April 2009. They used Jensen alpha, Snail Trail model, Sharpe index and Treynor index as performance measurement. They discovered Malaysian funds outperform Indonesian fund even in the event of economic crisis. However, in terms of the asset allocation funds Indonesian Islamic funds somewhat beat the Malaysian funds. It is also found that fund managers of Islamic mutual funds in both countries have a bad performance in market timing to increase the funds' returns.

Rahman et al. (2012) assessed Islamic funds' monthly returns in emerging market from 2005 through 2011 by using measurement tools of Jenson, Treynor, Sharpe and statistical models. The result of Jenson and Treynor indicated that most of the

Islamic funds outperformed the market benchmark. On the other hand, based on the Sharpe ratio finding, they found the funds were underperformed to the market in terms of the total risk, and thus add no diversification benefit to the investors.

Mansor and Bhatti (2011) investigated unit trust fund's performance during both bullish and bearish economic conditions in emerging market of Malaysia. They revealed that majority of the funds outperform the market. Moreover, it is found that during the year 1995 to 1996, Islamic funds tend to perform better but underperforming during year 2005 to 2006. They suggested that both funds will perform differently in different economic conditions. Nevertheless, the authors only focused on assessing the general performance of the funds and neglect the individual performance.

Bashir and Nawang (2011) examined Malaysian Islamic and conventional unit trust funds in regards of the risk, return and diversification for the 5 years period from 2002 to 2006. Jensen's alpha, Treynor index and Sharpe index were used as measurement tools and KLCI and KLSI are used as proxies to market benchmarks. They found that conventional funds performed better that KLCI and on opposing side, Islamic funds failed to beat KLSI's performance. In addition, this study indicated that fund managers for both funds are bad in market timing and have poor selection skills as well as to predict the price changes of the funds.

A comparative analysis between Malaysia Islamic and conventional funds companies in for 4 years period commencing 2002 through 2005 is done by Saad et al. (2010). They used Data Envelopment Analysis (DEA) to examine the competencies of the companies. It is revealed that in regards of the efficiency, Islamic companies outperformed the conventional companies. It is also revealed that companies' technical efficiency is the key cause to funds' efficiency. Nonetheless, since they only investigate 5 companies into this study, the result cannot represent the local companies' performance as a whole.

Kraeussl and Hayat (2008) evaluated the performance of 59 global funds from several countries for five year period from January 2002 through August 2006 and use Jensen alphas as measurement tool. It is found that 31 Malaysian funds slightly underperform the market benchmark, 21 global funds had an insignificant performance difference whether good or bad and the other 7 funds were significantly outperformed their market benchmark. However, there were several missing net asset values of the funds and they have to replace it by using the average of the previous and consequent study, therefore the result has to be taking in carefully. In 2011, they both further investigated the IEFs for ten years period from 2000 to 2009. A total of 145 IEFs are used as sample to examined their risk and return characteristics. It is revealed that IEFs are underperformed to the benchmarks. The result of underperform in IEFs to the benchmark continue to increase during the financial downturn. They also found that the IEF fund managers are perform poorly in market timing.

Taib and Isa (2007) on 110 unit trust funds covering equity balance and fixed income funds in 1991 until 2001 indicate that the unit trust performance is below the market portfolio. They also find that equity funds provide a negative return over all sub-periods despite having the most diversified portfolio as compared to fixed income unit trust funds. The highest *R* square shows that the equity unit trust funds are the most diversified portfolio compared to fixed income unit trust funds. They conclude that fixed income unit trust funds illustrate a greater performance than equity unit trust funds. Furthermore, by having fixed income unit trust funds, it helps to hedge an investment portfolio during a bearish market. Another explanation that may lead to greater performance by fixed income unit trust funds is the capital preservation and consistent return received by the funds through all sub-periods.

Abdullah et al. (2007) examined performance of Malaysian funds for the period of 10 years from January 1992 to December 2001. 21 Shariah funds and 55 conventional funds are used in this study. Sharpe index, Treynor index, and adjusted Sharpe index are used as performance measurement tools. They separated the periods into three special periods, which were pre crisis period which is from year 1992 to 1996, during crisis which is from 1997 to 1998 and post crisis period which is from 1999 to 2001. The conventional funds were also separated to governmental and non-governmental funds. They found Islamic funds are better during the crisis period while conventional fund better during good market. Thus, it is recommended to invest in Islamic Fund during bearish market and vice versa.

Fikriyah, Taufiq and Shamser (2007) conducted comparative performance of 14 Shariah funds and 51 conventional funds from the period of January 1992 to December 2001. They revealed that somewhat similar performance shown between the two groups of the funds, and both underperformed the benchmark. Moreover, during crisis and post crisis period, Shariah funds outperformed conventional funds whilst during pre-crisis period, conventional funds beat Shariah fund's performance.

Hayat (2006) investigated empirical evaluation on 59 Islamic equity fund (IEFs) on the funds' performance for 5 years period and found that there is no significant difference either performing well or bad than the benchmarks in normal market condition. It is also revealed that Malaysian IEFs slightly better in market timing while the fund managers of globally invested IEFs are better stock selection skills.

Moreover, he concluded that the Islamic equity funds are doing better than the benchmark during economic downturn in year 2002.

Elfakhani and Hassan (2005) studied 46 Islamic investment funds and categorized the sample into in eight sector-based type based on its regional or investment exposure of that particular sector. Malaysian equity funds, U.S. equity funds, global equity funds, emerging markets South Africa and, European equity funds, Asian equity funds, Small cap / technology fund and emerging markets equity fund are the categories. They used Islamic conventional indices as proxies to compare the funds' performance. The result revealed consistent findings in all the measurement tools and benchmarks. The best performance funds of all the sectors is the emerging markets fund, followed by American and the emerging markets of South Africa, whilst Asian equity funds is the last performance. Of the entire sample, a total of 29 funds are constantly outperform the market, while 11 funds do beat the market but depending on which measures and benchmark used. Another outcome they found is that Islamic funds' performance is better than the benchmarks during bearish market but underperform in bullish.

Shariff (2002) investigated 14 Islamic trust funds in Malaysia for 4 years period commencing 1999 through 2002. The funds' performance is then compared to the KLCI index that used as a proxy. The period are also separated into 3 stages which were a short term which is 12 months period, medium term which is 24 months period and a long term which is 36 months period. He also examines that 14 Islamic unit trusts' nature and characteristics. It is revealed that the all the funds were failed to beat the benchmark and risk free performance in short term and long term periods. On the other hand, majority of the fund's risk adjusted returns of expose were better than the market benchmark.

Abdullah et al. (2000) conducted a comparative performance of 53 conventional and 14 Islamic funds in Malaysia. In this study, they used Sharpe index, Treynor index and Modigliani as measurement tools. They discovered that all the funds were still performed slightly below the KLCI benchmark. The yields for all the funds are found to be fairly equal. But when they put the risk factor into the analysis, the Islamic funds outperformed the conventional funds during market recession. On the other hand, in bullish market, the conventional doing better than Islamic funds. Author believed that the investors have another alternative to switch their investment between these two group funds, depending on their personal preference and economic conditions.

Zaher and Hassan (2001) performed a comparative overview between 37 Islamic and 50 conventional equity funds for 3 years period commencing 1997 to1999. They revealed that the Islamic equity funds performing better than the conventional funds. However, the result has to be interpreted cautiously as they do not have statistical analysis to justify the finding.

Shamsher et al. (2000) conducted a comparative performance of 41 active and passive managed funds Malaysia for the 5 years period from 1995 to 1999. They used Treynor index, Sharpe index, and Jensen alpha as measurement tools. The findings reveal that both funds showed no significant differences in the fund's performance. The returns are for all the funds failed to beat the market performance. In addition to that, the funds are less diversified compared to FBMKLCI benchmark as the test results showed the funds have less than 50% diversification level. The fund manager's ability in market timing also failed to beat the market and selection skills of the actively managed funds are somewhat about the same with the passively managed funds.

Mohd Nawawi et al. (1999) performed a study on Malaysian funds covering 11 years from year 1984 to 1994. They focused on funds' performance and also investigated whether the management style in relation to economic condition, governance, personality, role, and have a relationship to the fund's performance. They found the funds unable to do better than the market in uptrend economic situation while in bearish market condition, majority of the funds experience lower losses. This findings appear somewhat differ with the result done by Leong (1997).

Arbi (1999) investigated Malaysian Islamic funds' performance and ranking Malaysia for six years and a 6 months covering January 1992 through June 1998. He focused on the 9 Islamic fund and used RHB Islamic Index as market benchmark to test the fund manager' ability in stock selection and price predicting, the fund's diversification's risk and the fund performance's consistency and whether the economic downturn in 1997 had affected the fund's performance. He revealed that that almost all of the funds are highly diversified and slightly risky than the market benchmark. Negative results were generated from adjusted Jensen alpha; adjusted Sharpe index, Treynor index and this stated that almost all Islamic funds failed to beat the market benchmark. It is also revealed that from July 1996 to June 1997 when there is a market downturn, almost half of Islamic funds outperformed the market and during the economic downturn most of the funds failed to beat the market portfolio.

Leong and Aw (1997) investigated 32 fund's performance and ranking for 13 years from January 1984 through December 1996. Kuala Lumpur Stock Exchange Composite Index (KLSE CI) and the Kuala Lumpur Emas Index (EMAS) were used as proxies to the market benchmark. . They found that almost all of the funds failed to beat both the benchmarks and the funds diversification level were less than 50%

of the benchmark's level. They also found that when EMAS was used as proxy, there are a few fund managers with better forecasting ability that manages to outperform the market with more diversified portfolio. However, they suggested that different benchmark will produce different results.

A study made by Leong (1997) investigated 13 Malaysian funds for 5 years covering from January 1992 through December 1996. FBMKLCI is used as market's proxy. He further investigates the fund's performance before and after the date of 19th March 1994 on which the Securities Commission announced the new guidelines for unit trusts in Malaysia. Treynor index, adjusted Jensen alpha and adjusted Sharpe index were used as measurement tools under the CAPM structure. He found that for both first sub-period and full period, majority the funds performed better the market as compared to second sub-period. He suggested that the uptrend market condition in 1993 is the reason for the outperforming results. In the other hand, the new unit trust funds guidelines and regulations which effective end of 1993 is believed to be the cause most of funds underperform to the market performance.

Annuar et al. (1997) conducted a performance review on 31 Islamic and conventional funds for 5 years period from 1990 to 1995. They used Treynor and Mazuy as measurement tool. They found that all the funds outperformed the market.This is further supported by Rozali and Abdullah (2006) where they find that the performance of Malaysian equity funds outperforms the market return over the period 1995 to 2004. Nevertheless, there is no significant difference in all of the fund's performance. This is consistent with Abdullah and Abdullah (2009) in their study of 26 domestically invested and 23 internationally invested funds during 2004 to 2008 and 2005 to 2008, respectively, by using Jensen alpha, Treynor index and

Sharpe index as performance measures. They revealed that there is no difference in both type of funds when Sharpe index were utilised.

Koh and Koh (1987) evaluated the performance of 19 funds for 4 years period from January 1980 through December 1984.they used Stock Exchange of Singapore All share Index (SES) as proxy to the market performance. They found that the risk and return characteristics of the fund are inconsistent with the funds' objectives. It is also revealed that the performances over time are not consistent, and failed to beat the market. The funds' also found to have low diversification level than the markets

Koh, Phoon and Tan (1989) examined 4 funds listed on the Singapore Stock Exchange for 9 years period commencing from January 1979 through December 1987. SES Index is used as proxy and Jensen alpha, Treynor index and Sharpe index as performance measurement tools. They found three out of four funds outperformed the market performance, although all the funds carry about the same systematic as market benchmark. The study also revealed that the performance in both least aggressive fund and the more aggressive investment funds are about the same.

Koh and Kee (1990) investigated at some factors of the investment fund's performance in Singapore for the 4 years period from 1980 through 1984. It is found that the funds are low in diversification level, having inconsistent performance throughout the 4 years and also the funds are underperforming the market benchmark.

Lee (1993) examined 21 funds in Singapore for 5 years period from January 1986 to December 1990. He found that in general almost all the funds failed to beat the market benchmark. However, although there funds was lack in performance's consistency and fund ranking, the funds' risk profile looked pretty stable. He also found the fund’s level of diversification and the systematic risk is lower than the market benchmark.

Ashraf (2012) evaluating the comparative performances of 159 Saudi Arabian Islamic and conventional funds from April 2007 to June 2011 during the global economic crisis market. He used Treynor and Mazuy and CAPM structure when measuring the fund’s performance and to find the fund manager‘s ability in and stock selection and market timing skill .He revealed that during the crisis, Islamic mutual funds performing better than conventional fund. Moreover, it is suggested than fund manager for Islamic fund are better in selecting the right stock during the crisis. Furthermore, he found that majority of the Islamic funds have negative market timing ability and it is believed due to the conservative nature of Islamic investment strategy.

Merdad et al. (2010) evaluated Islamic and conventional funds in Saudi Arabia for 3 years period from January 2003 to January 2010. They focused the study on the risk-return performance by using Jensen alpha, Treynor index and Sharpe index as performance measurement tools. They found that the Islamic funds tend to underperform than conventional funds during the good market condition, but outperform the conventional funds during the financial crisis.

In conclusion, conflicting results are found from the previous studies in regards the Islamic and conventional funds’ performance in the West, Malaysia, Singapore and Saudi Arabia. The mixed result on literature reviews mentioned above provide some evidence that not many studies in Malaysia, specifically evaluating the Islamic equity funds and determined whether if the Islamic equity better than conventional equity funds compared to the market benchmark’s performance. Generally, both

Islamic and conventional funds have a tendency to outperform in bearish periods; however, the expectations are not met in the economic period revealed by both Mohd Nawawi et al. (1999) and Shariff (2002).

Table 2.1

Summary of past studies on performance of unit trust funds

Author/s	Coverage		Methodology	Findings
	Period	Funds covered		
Firth (1977)	1965 to 1975	72 U.K funds	Capital Asset Pricing Model and Sharpe's Reward Variability Index	• Fund managers in the U.K were unable to forecast the share price precisely toward a simple buy and hold strategy and concluded U.K fund managers are poor in predicting the price movement.
Ippolito (1993)	1962 to 1991	143 mutual funds	Jensen measurement	• The funds outperform the market indices • The returns of the fund are consistent with the funds' risk-adjusted performance exclusive of expenses and the performances are comparable to the indices
Luther et al. (1992)	1984 to1990	15 U.K SRI funds	Jensen alpha and Sharpe ratio	• The funds failed to outperform the market index
Luther and Matatko (1994)	1985 to 1992	9 SRI funds	Jensen alpha performance measure	• If the funds were compared to a small cap benchmark, it will improve the funds relative performance significantly
Fletcher (1999)	January 1985 to December 1996	85 U.K unit trusts with North American	Capital Asset Pricing Model	• No correlation is found between the charges of the funds and abnormal return performance
Statman (2000)	May 1990 to September 1998	31 socially responsible equity funds and 62 unscreened	Jensen's alpha	• Socially responsible funds were underperforming relative to both S&P 500 and the Domini Social Index, and it is better than the performance of conventional mutual funds of similar size

		conventional funds		
Hoepner, Rammal and Rezec (2009)	September 1990 to April 2009	262 Islamic equity funds	One factor model, 3 level Carhart model, and conditional 3 level Carhart model	• Islamic equity funds displayed superior in developed Islamic financial markets • Fund from the Western that have less Islamic assets show significantly underperform than market
Yaccob, Karim and Khalid (2015)	January 2007 to December 2014	5 Islamic and 5 conventional unit trusts	Treynor-Index, Jensen Alpha Index, and Sharpe-Index	• During crisis all the funds were outperform the market benchmark • After crisis showed 3 three Islamic funds and 3 conventional funds outperformed the market • Conventional funds showed higher value of standard deviation than Islamic fund
Bukhari and Azam (2015)	January 2006 to December 2014	224 Islamic funds and 573 socially responsible funds	Treynor–Mazuy and Jensen's alpha	• Both IEFs and SRIs have lower risks • Both IEFs and SRIs underperform relative to the market benchmark • Both IEFs and SRIs's fund managers have about the same market timing ability
Kusairi et al. (2013)	January 2000 to June 2012	420 Malaysian mutual funds	Regression analysis for panel data	• All the funds except Asia Pacific geographic group underperformed the benchmark • Most of the fund managers are bad in market timing
Suhana et al. (2012)	January 2005 until December 2009	4 Islamic unit trust funds with 4 conventional unit trust funds	Sharpe, Treynor and Jensen measurement	• Sharpe and Treynor index showed that both Islamic and conventional unit trust funds underperform the market • Jensen index showed a negative value and this indicate that fund managers having poor skill to manage the unit trust funds
Rahman et al. (2012)	2005 to 2011	15 growth oriented mutual funds of Dhaka Stock Exchange (DSE)	Jenson, Treynor, Sharpe and statistical models	• Most of the mutual funds perform better in the market according to Jenson and Treynor but not up to the benchmark for the Sharpe ratio

Mansor and Bhatti (2011)	January 1999 to May 2009	128 mutual funds	Sharpe ratio, Treynor Index, Jensen's alpha, Modigliani measure, information ratio and adjusted Sharpe ratio	• Both Islamic and conventional mutual fund outperform the market
Bashir and Nawang (2011)	2002 to 2006	11 Islamic and 29 conventional unit trust in Malaysia	Sharpe Index, Treynor Index and Jensen's Alpha	• Conventional funds outperform the market and on the opposing side, Islamic funds underperform the market • Fund managers for both funds are bad in market timing
Abdullah and Abdullah (2009)	June 2004 to May 2008 and June 2005 to May 2008	26 domestically invested and 23 internationally invested unit trust funds	Sharpe, Treynor and Jensen performance measures	• The mean returns of the local funds appear to exceed those of the international funds. • No difference between performance of unit trust funds domestically invested and internationally invested unit trust funds when the returns are risk-adjusted using the Sharpe measure
Taib and Isa (2007)	January1991 until December 2001	110 Malaysian unit trust funds covering equity balance and fixed income funds	Seven different performance measure used include Sharpe Treynor Jensen	• All the funds' performance is below the market portfolio • equity funds provide a negative return over all sub-periods despite having the most diversified portfolio as compared to fixed income unit trust funds
Abdullah et al. (2007)	January 1992 to December 2001	21 Malaysian Islamic unit trust funds and 55 conventional unit trust funds	Sharpe index, adjusted Sharpe index and market timing and selectivity ability	• Islamic funds are better during the crisis period while conventional fund better during good market
Fikriyah, Taufiq and Shamser (2007)	January 1992 to December 2001	14 Islamic unit trusts and 51 are conventional funds	Treynor & Mazuy 1966 model	• No difference in terms of performance between the two groups of the unit trusts, and both underperformed the market. • Islamic unit trusts to have better performance than

				the conventional unit trusts during the crisis and post-crisis period, while the conventional unit trusts outperform the Islamic unit trusts during the pre-crisis period
Rozali, Abdullah and Fikriyah (2006)	January 1994 to December 2004	102 Malaysian funds	Jensen Alpha and Treynor & Mazuy	• All the funds outperforms the market return • Poor market timing • Diversification of funds are low and below expectation
Hayat (2006)	August 2001 to August 2006	59 Islamic equity fund	Jensen alpha, Sharpe ratio, Treynor ratio and MM information ratio	• No significant difference either performing well or bad than both conventional and Islamic benchmarks in normal market condition • Islamic funds significantly outperform both Islamic and conventional benchmarks during bear market in 2002
Elfakhani, Hassan and Sidani (2005)	January 1997 to August 2002	46 Islamic investment funds	Sharpe and Treynor Ratios and Jensen's alpha and ANOVA	• Performances of Islamic funds' performance are better in both benchmarks (Islamic and conventional) during bearish market but underperform in bullish
Abdullah et. al. (2002)	January 1995 to June 2000	14 Islamic and 53 Conventional Funds	Sharpe ratio, the Modigliani and measuring the ratio information	• Islamic and conventional funds slightly performing below than the Kuala Lumpur Composite Index (KLCI) benchmark • When taking the risk into account, the Islamic equity funds (IEF) do better than conventional funds during bear markets while conventional tend to outperforming in bullish market
Zaher and Hassan (2001)	1997 to 1999	37 Islamic Equity Funds (IEFs) and 50 conventional funds	Sharpe, Treynor and Jensen performance measures	• IEFs tend to perform better compared to the conventional funds

Shamsher et al. (2000)	January 1995 to December 1999	41 Malaysian actively and passively managed funds	Sharpe's index, Treynor's index and Jensen's index	• Both actively and passively managed funds showed no significant differences in their performance and their returns are lower than the market portfolio • The diversification levels of the funds are less than 50% of market index of FBMKLCI's diversification level
Mohd Nawawi et al. (1999)	1984 to 1994	45 Malaysian funds	Treynor Index and Jensen Alpha	• The funds unable to do better than the market in uptrend economic situation while in bearish market condition, majority of the funds experience lower losses
Arbi (1999)	January 1992 to June 1998	9 Malaysia Islamic funds	Adjusted Sharpe Index, Treynor Index and Adjusted Jensen's Alpha	• Overall Islamic unit trust funds were underperform the market portfolio • Almost all of the funds are highly diversified and slightly risky than the market portfolio
Koh and Koh (1987)	January 1980 to December 1984	19 investment funds	Jensen index, Sharpe Ratio and Treynor index	• The performances over time are not consistent, and failed to beat the market. • The funds' also found to have low degree of diversification • The risk and return characteristics of the fund are inconsistent with the funds' objectives
Koh, Phoon and Tan (1989)	January 1979 to December 1987	4 investment funds	Alpha Sharpe Ratio, Treynor index and Jensen index	• Three investment funds out of four exceeded the market portfolio, although all of the funds carry systematic risk close to that of the market portfolio. • The performance in both least aggressive fund and the more aggressive investment funds are about the same.
Koh and Kee (1990)	January 1980 through December	11 investment funds	Sharpe ratio, Treynor ratio and Jensen Alpha	• The funds are low in diversification level, having inconsistent performance throughout the 4 years and also the funds are underperforming the market

	1984			benchmark.
Lee (1993)	January 1986 to December 1990	21 unit trust funds	Sharpe, Treynor and Jensen performance measures	• All the unit trust examined was underperformed the market benchmark • The systematic risk and the degree of diversification of funds portfolio were lower than the market
Ashraf (2012)	April 2007 to June 2011	159 Saudi Arabian Islamic mutual funds and conventional funds	Standard CAPM regression and Treynor and Mazuy	• During the crisis, Islamic mutual funds performing better than conventional fund • Majority of the Islamic funds have negative market timing ability and it is believed due to the conservative nature of Islamic investment strategy
Merdad et al. (2010)	January 2003 to January 2010	Islamic and conventional mutual funds	Sharpe, Treynor, and Jensen Alpha	• Islamic funds tend to underperform than conventional funds during the good market condition, but outperform the conventional funds during the bearish market and also during the financial crisis.

CHAPTER 3

METHODOLOGY

3.1 Introduction

This chapter describes the research design and research method used to examine Islamic and conventional equity fund's performance in terms of risk and return analysis.

3.2 Selection Of Sample Funds and Data Collection

As at 30 June 2016, there were 35 fund management companies with 640 approved unit trust funds in Malaysia which 620 of the 640 approved funds were successfully launched into the market. The 20 approved funds from 640 are pending for launching by the respective companies. 198 of the launched funds are Islamic funds and 422 are conventional funds.[1] Statistically, about 31.9% of the approved funds comply with the Shariah law. Meanwhile, 63% of the total launched funds were classified as equity fund which in total was 396 funds.[2]

The limited literature provides space for further insight into the topic. Further, the period of this study which is from 2011 to 2015, is important as far as the financial performance of Islamic funds is concerned. The 18.6% in growth rate over 5 years from 2011 to 2015 in the fund management industry's compound annual growth rate (CAGR) has been largely caused by the fast growth in the unit trust industry. During that period, the net asset value (NAV) for all the funds increased to RM346.6 billion

[1] www.sc.com.my
[2] http://www.fimm.com.my/resources/publications/annual-report

in 2015 compared to RM249.5 billion in 2011. It is estimated that the assets under management (AUM) will be to RM1.6 trillion in 2020.[3]

The fund industry fast development can be seen from the data and statistics from 2011 to 2015. Total approved funds were increase from 584 to 631 where conventional funds decrease from 437 to 433 and Islamic funds jump from 167 to 198. There is a sharp increase in approved Islamic funds between these 5 years period. Looking into the total NAV in 2015, it was RM346.6 billion where conventional funds was RM294.5 billion and Islamic funds was RM52.1 billion and NAV to Bursa Malaysia Market Capitalism was 20.46% in 2015. But in 2011, total NAV was RM249.5 billion where conventional was RM221.6 billion and Islamic based was RM27.9 billion and NAV to Bursa Malaysia Capitalism was 19.42%. The total NAV for conventional funds increase by 32.9% during the 5 years while total NAV for Islamic funds increase sharply by 86.73%. However, when looking at the number of management companies during the 5 years, there is a decreasing amount from 40 to 37 companies.

For that reason, to conduct this study, 18 Islamic equity (out of 97) and 32 conventional funds equity (out of 299) were taken from Bloomberg Terminal because they have complete data from January 2011 to December 2015. The entire selected samples are geographically invested locally in Malaysia region so that the comparison results of the Islamic and conventional reflect fair result as we excluded equity funds that invested in other region such ASEAN countries, US, and Europe.

[3] Capital Markets Malaysia FINANCING THE FUTURE, Securities Commission Malaysia 2015, http://www.capitalmarketsmalaysia.com/wp-content/uploads/2015/06/factsheet-financing.pdf

This is because geography factor bring different effect on the funds' performance as different risk will be faces by the funds as they have other countries' stock markets on where the investors' money will be invested internationally. As a result, the sample use in this study was about 36% of Islamic and 64% conventional equity funds. Given that the fact this study covers 5 years periods from January 2011 through December 2015, the sample selected funds are funds that existed prior to 1 January 2011 and still be traded as at 3[1] December 2015. Hence, the funds that were recently commence into the market or unavailability of adequate monthly data is debarred. Table 1 and Table 2 list the Islamic and conventional equity funds that are being investigated in this study.

The weekly data on net asset value, weekly FTSE Bursa Malaysia KLCI, weekly FTSE Bursa Malaysia Emas Shariah which is used as a proxy of the market return and weekly 3-month Malaysian Treasury Bills representing the risk free rate over a period of 60 months from January 2011 to December 2015 were extracted from Bloomberg Terminal. Another source of data are the daily quotations from the Fundsupermart, an online website on unit trust distribution, newspapers such as The Edge, New Strait Times and The Star, and the news from the Securities Commission.

As the study attempts to compare Islamic equity unit trust funds with conventional equity funds between market benchmark, the main attributes of the market benchmark used is as follows:

a) Islamic equity funds:

The FTSE Bursa Malaysia EMAS Index (FBMEMAS) is Shariah index that comprise of large and mid-cap constituents of FTSE Bursa Malaysia 100 Index and FTSE Bursa Malaysia Small Cap Index. The constituents are screened according to the Shariah Advisory Council (SAC) screening methodology. Accordingly it is used in this study as the benchmark for market returns in comparison to Islamic equity funds. The benchmark provides remarkable comparisons of performance between Islamic funds.

b) Conventional equity funds:

The FTSE Bursa Malaysia Index (FBMKLCI) is a value weighted market based index of 30 Malaysian companies listed in Bursa Malaysia that meet stated eligibility requirements. Accordingly it is used in this study as the benchmark for market returns in comparison to conventional equity funds.

	Fund Name	Bloomberg Ticker	Inception Date	Total Fund Size (RM'000) (As At 30/06/2016)
1	Amanah Mutual Berhad Dana Yakin	MAYDANA MK Equity	Friday, November 24, 2000	39,240
2	PMB Dana Mutiara	ASMFBPI MK Equity	Thursday, August 05, 2004	5,820
3	PMB Syariah Aggressive Fund	ASMBPSI MK Equity	Monday, November 21, 2005	70,310
4	PMB Syariah Dividend Fund	ASMSYDV MK Equity	Monday, July 21, 2008	5,280
5	Affin Islamic Equity Fund	AFFISEQ MK Equity	Wednesday, August 01, 2007	83,200
6	KAF Dana Adib	ALLADIB MK Equity	Thursday, March 25, 2004	36,580
7	AmIslamic Growth Fund	AMISGR MK Equity	Friday, September 10, 2004	17,770
8	AmIttikal	ABMLTII MK Equity	Tuesday, January 12, 1993	198,810
9	BIMB i-Growth Fund	BIMASBI MK Equity	Thursday, June 30, 1994	32,950
10	PMB Dana Al Aiman	ASMDAAI MK Equity	Monday, May 19, 1997	47,380
11	PMB Dana Bestari	ASMEBPI MK Equity	Thursday, October 03, 2002	8,640
12	Eastspring Investments Dana al-Ilham	PRUALIL MK Equity	Wednesday, August 14, 2002	404,750
13	Affin AIIMAN Growth Fund	HWAIZDI MK Equity	Tuesday, October 08, 2002	38,900
14	Inter-Pacific Asset Management - InterPac Dana Safi	IPDASAF MK Equity	Wednesday, July 25, 2007	4,090
15	Kenanga Islamic Fund	CMSISLA MK Equity	Thursday, August 15, 2002	63,400
16	Kenanga Syariah Growth Fund	KUTEQIS MK Equity	Tuesday, January 29, 2002	247,720
17	MIDF Amanah Islamic Fund	ASMTABI MK Equity	Wednesday, May 14, 1997	6,880
18	RHB Dana Islam	OSKDANA MK Equity	Friday, October 26, 2001	20,720

Table 3.1

Islamic Equity Unit Trust Funds, Inception Dates, Total Fund Size

	Fund Name	Bloomberg Ticker	Inception Date	Total Fund Size (RM'000) (As At 30/06/2016)
1	Amanah Mutual Berhad Dividend Trust Fund	MAYDVDT MK Equity	Tuesday, June 06, 2006	181,820
2	Amanah Mutual Berhad Ethical Trust Fund	MAYETHT MK Equity	Tuesday, January 07, 2003	199,660
3	Amanah Mutual Berhad Index-Linked Trust Fund	MAYINDX MK Equity	Thursday, May 16, 2002	16,210
4	Amb SmallCap Trust Fund	MAYSCAP MK Equity	Wednesday, March 03, 2004	106,860
5	Amb Unit Trust Fund	MAYUTFI MK Equity	Thursday, March 26, 1992	74,030
6	Amanah Mutual Berhad Value Trust Fund	MAYVALT MK Equity	Tuesday, January 07, 2003	426,720
7	PMB Shariah Mid-Cap Fund	ASMFPFI MK Equity	Monday, April 20, 1992	25,560
8	Affin Hwang Equity Fund	AFFEQYF MK Equity	Thursday, April 29,1993	90,600
9	KAF Core Income Fund	ALLOPTI MK Equity	Thursday, September 02, 2004	16,630
10	Alliance Tactical Growth Fund	ALLTACG MK Equity	Thursday, September 02, 2004	20,300
11	Alliance Vision Fund	MPVSNFD MK Equity	Wednesday, March 01, 2000	61,640
12	AmDividend Income	AMDIVIN MK Equity	Monday, March 28, 2005	39,990
13	Areca Capital - Areca EquityTrust Fund	AREEQTR MK Equity	Monday, April 23, 2007	52,080
14	CIMB-Principal Equity Aggressive Fund 3	COMFGLI MK Equity	Thursday, March 12, 1998	67,220
15	Eastspring Investments Equity Income Fund	PRUEQIN MK Equity	Monday, October 18, 2004	141,470
16	Eastspring Investments Growth Fund	PRUGROW MK Equity	Tuesday, May 29, 2001	115,240
17	Eastspring Investments Small Cap Fund	PRUSCAP MK Equity	Tuesday, May 29, 2001	328,660
18	Inter-Pacific Asset Management - InterPac Dynamic Equity Fund	IPDASAF MK Equity	Wednesday, July 25, 2007	4,570
19	RHB KLCI Tracker Fund	OSKTRAK MK Equity	Monday, April 03, 2000	13,450
20	Kenanga Growth Fund	KUTNETF MK Equity	Monday, January 17, 2000	690,230
21	Kenanga Premier Fund	UTSPRFI MK Equity	Tuesday, November 26, 1996	83,720
22	MIDF Amanah Dynamic Fund	ASMABRI MK Equity	Wednesday, May 05, 1976	2,450
23	MIDF Amanah Growth Fund	ASMAINI MK Equity	Friday, December 02, 1966	10,130
24	MIDF Amanah Strategic Fund	ASMAPRI MK Equity	1970	20,890
25	RHB Emerging Opportunity Unit Trust	OSKEOPP MK Equity	Tuesday, May 18, 2004	39,770
26	RHB Small Cap Opportunity Unit Trust	OSKSCOI MK Equity	Monday, April 20, 1998	71,890
27	RHB Smart Treasure Fund	OSKTREA MK Equity	Tuesday, September 07, 2004	160,500
28	RHB Thematic Growth Fund	OSKUTGF MK Equity	Wednesday, September 26, 2007	26,260
29	RHB Capital Fund	RHBCPFI MK Equity	Wednesday, April 12, 1995	158,510
30	RHB Dynamic Fund	RHBDYFI MK Equity	Tuesday, September 15, 1992	38,890
31	RHB Malaysia DIVA Fund	RHBMALY MK Equity	Monday, May 03, 1999	9,030
32	TA Small Cap Fund	TASCAPF MK Equity	Monday, February 09, 2004	7,070

Table 3.2

Conventional Equity Unit Trust Funds, Inception Dates, Total Fund Size

3.3 Theoretical Model

Sharpe, Jensen and Treynor Performance Model are the measurement tools that being employed to evaluate unit trusts portfolio performance because the only fair way to compare the two types of investments is on a risk adjusted return basis.[4] These models were used to rank and estimating the funds' performance.

Islamic equity funds' performances were compared towards FBMEMAS index during the periods under investigation while the conventional equity funds will be compared towards FBMKLCI index. The performance of both Islamic and conventional equity funds will be evaluated towards each other. The 3-month Malaysian Treasury Bills are used as risk free returns in calculating the indices. The fund's risk adjusted performances were then ranked according to the three measurement tools.

3.3.1 Treynor Performance Model

Treynor (1965) examines 57 open-ended fund's performance covering the period of 1953 to 1962. The findings reveal that investors in unit trust funds rely on the variability of the market index. He concludes that fund managers of the 57 funds do not outperform the market. The Treynor ratio uses a systematic risk component of the portfolio's return as measured by (β_i) (portfolio's beta coefficient) in relation to market portfolio's return. It also evaluates the ability of a portfolio to get an extra return that has been adjusted for systematic risk. Treynor ratio is quite similar to the Sharpe ratio except for risk evaluate. Treynor index can be calculated as follows:

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[4] https//wealthfront.com/benchmark-diversified-portfolio/

$$T_i = \frac{R_i - R_f}{\beta_i} \quad (1)$$

Where:

R_i = average return on fund i

R_f = average return on 3-month Malaysian Treasury Bills

β_i = Beta of the unit trust fund over the evaluation period

Given that the published Malaysian Treasury Bill rate is an annualized holding period yield on a 3-month, it has to be converted into a weekly equivalent, so that it consistent with the market's return and the weekly returns of the unit trust funds. Essentially, the formula to compute the evaluation of weekly equivalents of the annualized yield is$(1 + Annualized\,Yield)^{1/52} - 1$ as a geometric mean used by Soo-Wah (2007).

3.3.2 Sharpe Performance Model

Sharpe (1966) proposes a more complex measurement in evaluating the funds' performance. Rather than just looking at systematic risk($\boldsymbol{\beta_i}$), total risk of the portfolio represented by standard deviation of return is utilized (Reilly & Brown, 2009). The Sharpe ratio utilizes a standard deviation which evaluates both systematic risk and unsystematic risk while Treynor ratio only uses the component of systematic risk. Meanwhile, Sharpe index measure the excess return per unit of risk.

It measures reward-to-risk of a portfolio. Thus, the higher the Sharpe's result shows the better risk-adjusted performances of the funds. Therefore, the ratios are assessing both the risk and return, and finally convey a single measure that is comparative to the risk-adjusted returns. It is also considered to be useful for investors as it could evaluate fund performance by looking at the amount of risk involved. Even though a particular fund could present superior return, it would only be regarded as superior investment if there is less risk involved to generate such return. The formula to measure the Sharpe index is as follows:

$$S_i = \frac{R_i - R_f}{\sigma_i} \tag{2}$$

Where:

R_i = average return on fund i

R_f = average return on 3-month Malaysian Treasury Bills

σ_i= standard deviation (total risk) of returns for fund

The average weekly returns of fund i (R_i) for Treynor and Sharpe are calculated based on the following formula:

$$R_{it} = \frac{NAV_{it} - NAV_{it-1}}{NAV_{it-1}} \tag{3}$$

Where:

R_{it}= Return of fund i in period $_t$

NAV_{it}= Net Asset Value of fund i in period $_t$

NAV_{it-1}= Net Asset Value of fund i in period $_{t-1}$

3.3.3 Jensen Performance Model

Jensen's (1968) measurement is based on the capital asset pricing model (CAPM) structure. The most important benefit when applying Jensen measurement tool is that it corrects for market risk and primarily evaluates security selection skill, market timing skill or the combination of the skills of the fund manager. It is also easy to understand and to interpret the results. For example, an alpha value of 0.04 shows that the fund has produced a return of 4% during the time horizon of evaluation. The equation below is used to measure the Jensen index:

$$R_{it} - RFR = \alpha_i + \beta_i(R_M - RFR) + \check{e}_{it} \quad (4)$$

Where:

$R_{it} - RFR$ = Excess returns of portfolio i in period $_t$

$(R_M - RFR)$ = Excess return of market portfolio proxied by FBMKLCI index

α_i = Jensen's alpha to measure portfolio performance

β_i = The systematic risk (beta) for Portfolio i

$\check{e}_{it}$ = The random error term

The α_i value specifies the fund manager's ability in selection skills and market timing to perform better or poorer than the market benchmark.

A significant positive α_i indicates that a fund has superior performance because of consistent differences as the fund manager stock selection skills capability to outperform the market. Meanwhile, a significant negative α_i provides inferior performance of funds because its return is not above the expectation of capital asset pricing model that results in consistent negative differences (Lai & Lau, 2010). It is suggested that higher the index value means the better the fund's performance of it. As for an investor, the α_i value is significant to look at as it shows how much the funds is able to generate extra returns as compared to the return by the market benchmark.

The average weekly risks of fund i for Treynor and Sharpe are calculated based on the following formula. The equation of standard deviation is shown:

$$Standard\ Deviation, \sigma = \sqrt{\frac{\sum(R-\bar{R})^2}{(n-1)}} \quad (5)$$

Where:

σ = The Standard deviation on portfolio i

R = Return of a fund

R¯ = Mean Return of the fund

n = Number of weekly returns

There are two ways to measure risk in this study. The said measures are standard deviation and beta. As mentioned above, total risk of the funds will be calculated by standard deviation. For the calculation of systematic risk(β_i), the slope coefficient of regression of the fund rate of return on the market rate of return is used. Correspondingly, the formula for it is by dividing the covariance of the return of funds with the standard deviation of the market:

$$\beta_{(fund\ i)} = Cov_{(fund\ i,KLCI)} / \sigma^2{}_{KLCI} \quad (6)$$

FBMKLCI's weekly returns are used as proxy for the market returns.

3.4 Methodology

To investigate the performance of Islamic and conventional equity fund, the data comprise weekly data on net asset value (NAV), weekly FBMKLCI, weekly FBMEMAS which is used as proxies of the market return and weekly 3-month Malaysian Treasury Bills representing the risk free rate for 60 months period from January 2011 to December 2015 is evaluated.

CHAPTER 4

ANALYSIS AND FINDINGS

4.1 Introduction

This chapter provide the analysis and findings of the study. The performance of Islamic equity funds is compared towards conventional equity funds. The performances of both types of funds are then compared to their respective market benchmarks to determine whether they outperformed the market benchmark or not. The FBMEMAS index is used as the market benchmark for Islamic equity funds and FBMKLCI index as market benchmark for conventional equity funds. A total of 18 Islamic equity funds and 32 conventional equity funds are evaluated by using three performance measures which are Jensen alpha, Treynor index and Sharpe index.

4.2 Results of the Study

Table 4.1 provides the return, risk and performance measures of the Islamic equity funds. Table 4.2 consists of return, risk and performance measures for conventional equity funds. Table 4.3 presents the summary of average weekly return obtain from estimating the return, total risk and coefficient of variation for Islamic equity funds for the period of January 2011 until December 2015. Table 4.4 presents the summary of average weekly return obtain from estimating the return, total risk and coefficient of variation for conventional equity funds for the period of January 2011 until December 2015. Table 4.5 shows average returns and risks profiles of Islamic and conventional equity funds for 60-month period from January 2011 to December 2015. Table 4.6 presents the differences in average risks of Islamic and conventional equity funds and Table 4.7 show the summary of funds' performance ranking for 18 Islamic and 32 conventional equity funds.

Table 4.1
Weekly Performance Measures for Islamic Equity Funds: January 2011 – December 2015

	Fund Name	Average Return (%)	Standard Deviation (%)	Coefficient of Variation	Beta	Sharpe	Treynor	Jensen
1	Amanah Mutual Berhad Dana Yakin	0.0032%	1.6451%	520.7159439	0.8803	-0.0318	-0.0006	-0.0004
2	PMB Dana Mutiara	-0.0418%	1.4365%	-34.3825446	0.2044	-0.0677	-0.0048	-0.0009
3	PMB Syariah Aggressive Fund	0.2753%	2.1192%	7.698042806	0.2812	0.1037	0.0078	0.0022
4	PMB Syariah Dividend Fund	0.2958%	4.4300%	14.97426626	0.2682	0.0542	0.0090	0.0026
5	Affin Islamic Equity Fund	-0.0102%	1.4017%	-137.831162	0.8513	-0.0469	-0.0008	-0.0002
6	KAF Dana Adib	0.0951%	1.3451%	14.14283408	0.8618	0.0294	0.0005	0.0009
7	AmIslamic Growth Fund	0.1565%	1.4861%	9.496295444	0.9859	0.0679	0.0010	0.0012
8	AmIttikal	0.0279%	1.4797%	53.07598828	0.9447	-0.0187	-0.0003	-0.0001
9	BIMB i-Growth Fund	0.0431%	1.3022%	30.20801095	0.8366	-0.0095	-0.0001	0.0000
10	PMB Dana Al Aiman	-0.1211%	2.0575%	-16.9883979	0.0298	-0.0859	-0.0592	-0.0018
11	PMB Dana Bestari	0.5126%	8.6577%	16.8911679	0.5396	0.0528	0.0085	0.0047
12	Eastspring Investments Dana al-Ilham	-0.0661%	3.4362%	-51.9528838	0.7956	-0.0354	-0.0015	-0.0011
13	Affin AIIMAN Growth Fund	0.0690%	1.6725%	24.23407345	0.8024	0.0081	0.0002	0.0003
14	Inter-Pacific Asset Management - InterPac Dana Safi	0.0698%	1.3869%	19.87119719	0.6805	0.0103	0.0002	0.0003
15	Kenanga Islamic Fund	0.1027%	1.5798%	15.37617647	0.9095	0.0299	0.0005	0.0006
16	Kenanga Syariah Growth Fund	-0.1395%	4.3380%	-31.1008347	0.4954	-0.0450	-0.0039	-0.0019
17	MIDF Amanah Islamic Fund	-0.0305%	1.7771%	-58.327973	0.9803	-0.0484	-0.0009	-0.0007
18	RHB Dana Islam	0.0417%	1.7074%	40.93868906	0.9193	-0.0081	-0.0002	0.0000
	Average	**0.0713%**	**2.4033%**	**24.2799383**	**0.6815**	**-0.0023**	**-0.0025**	**0.0003**
	FBMS	**0.0387%**	**1.4053%**	**36.34911193**	**1.0000**	**-0.0120**	**-0.0002**	**0.0000**
	Malaysia T-Bills	**0.0606%**	**0.0029%**	**0.047343206**	**0.0001**	**1.7747**	**0.5119**	**0.0001**

Table 4.1 presents the results of weekly performance for Islamic equity funds from January 2011 to December 2015, which is represented by 18 funds. Islamic equity funds' performance is equivalent to FBMEMAS benchmark since there is an only small difference to the average returns of the market with gap of 0.0326%. On average, Islamic equity funds yield a positive return of 0.0713% while the market's average return is 0.0387%. Individually, almost all the funds have positive return.

The total risk as measured by standard deviations reveals that 14 out of the 18 funds exceed the FBMEMAS's total risk. The standard deviation of FBMEMAS is

1.4053% as compared to the funds' standard deviations that range from 1.3022% to 8.6577%. The fund with the higher total risk and return is PMB Dana Bestari funds with 8.6577% weekly standard deviation and 0.5126% weekly returns. In comparison, FBMEMAS's weekly return is merely 0.0387%. There are 10 out of 18 funds that generate higher return than the FBMEMAS.

The Sharpe index result for FBMEMAS is -0.012 expose that 10 out of 18 Islamic equity funds performing slightly better than the FBMEMAS. The highest Sharpe measure is PMB Syariah Aggressive Fund with a positive result of 0.1037. The higher Sharpe index value is, the more attractive is the fund. Thus, PMB Syariah Aggressive Fund is a good investment because it offered second highest returns but not carry lot of extra risk if compared with the fund with the highest return which is PMB Syariah Dividend Fund. This PMB Syariah Aggressive Fund invests actively about 80% to 99.5% of its NAV in Shariah-compliant equity and equity-related securities. The balance of the NAV will be invested into Shariah compliant money market and fixed deposits. [1] It is believed this investment strategy is the reason for a high capital return. Nevertheless, almost half of the funds produce negative values in Sharpe measure even they are outperform the market. Furthermore, both Treynor and Jensen alpha's results shows 10 out of 18 Islamic equity funds outperform the FBMEMAS benchmark. As a result, it seems that Islamic equity funds' performance is just equal to its FBMEMAS market performance.

[1] www.pmbinvest.com.my

Table 4.2
Weekly Performance Measures for Conventional Equity Funds: January 2011 - December 2015

	Fund Name	Average Return (%)	Standard Deviation (%)	Coefficient of Variation	Beta	Sharpe	Treynor	Jensen
1	Amanah Mutual Berhad Dividend Trust Fund	-0.0963%	2.2777%	-23.6640	0.5419	-0.0666	-0.0028	-0.0014
2	Amanah Mutual Berhad Ethical Trust Fund	-0.1265%	2.3057%	-18.2245	0.8699	-0.0790	-0.0021	-0.0016
3	Amanah Mutual Berhad Index-Linked Trust Fund	-0.0814%	1.7776%	-21.8326	0.9707	-0.0770	-0.0014	-0.0011
4	Amb SmallCap Trust Fund	0.0354%	1.6916%	47.7694	0.8702	-0.0119	-0.0002	0.0000
5	Amb Unit Trust Fund	-0.0235%	1.5831%	-67.2681	0.7809	-0.0499	-0.0010	-0.0006
6	Amanah Mutual Berhad Value Trust Fund	-0.2096%	2.3505%	-11.2152	0.8071	-0.1128	-0.0033	-0.0025
7	PMB Shariah Mid-Cap Fund	-0.0554%	1.2841%	-23.1894	0.1455	-0.0864	-0.0076	-0.0011
8	Affin Hwang Equity Fund	-0.0005%	1.3307%	-2544.3216	0.7772	-0.0421	-0.0007	-0.0004
9	KAF Core Income Fund	-0.0087%	1.4596%	-168.2167	0.6579	-0.0440	-0.0010	-0.0005
10	Alliance Tactical Growth Fund	-0.0435%	1.8128%	-41.7116	1.1125	-0.0546	-0.0009	-0.0007
11	Alliance Vision Fund	0.0698%	3.2060%	45.9322	0.7779	0.0044	0.0002	0.0003
12	AmDividend Income	0.0825%	1.4289%	17.3226	0.8702	0.0189	0.0003	0.0005
13	Areca Capital - Areca EquityTrust Fund	0.0175%	1.9061%	108.8267	0.7984	-0.0199	-0.0005	-0.0002
14	CIMB-Principal Equity Aggressive Fund 3	0.0612%	1.3917%	22.7468	0.8840	0.0041	0.0001	0.0003
15	Eastspring Investments Equity Income Fund	0.0463%	1.3671%	29.5309	0.6783	-0.0068	-0.0001	0.0001
16	Eastspring Investments Growth Fund	-0.1175%	3.5407%	-30.1454	1.0317	-0.0489	-0.0017	-0.0015
17	Eastspring Investments Small Cap Fund	-0.1219%	4.9572%	-40.6699	0.0022	-0.0358	-0.8002	-0.0018
18	Inter-Pacific Asset Management - InterPac Dynamic Equity Fund	0.0698%	1.3869%	19.8712	0.6206	0.0103	0.0002	0.0003
19	RHB KLCI Tracker Fund	0.0619%	1.4014%	22.6383	1.0054	0.0045	0.0001	0.0003
20	Kenanga Growth Fund	-0.0265%	4.3882%	-165.8375	0.4987	-0.0187	-0.0016	-0.0007
21	Kenanga Premier Fund	0.0239%	1.5676%	65.6315	0.8369	-0.0202	-0.0004	-0.0001
22	MIDF Amanah Dynamic Fund	-0.0169%	1.8919%	-111.7234	0.8449	-0.0383	-0.0009	-0.0005
23	MIDF Amanah Growth Fund	-0.0794%	1.7742%	-22.3545	0.7969	-0.0760	-0.0017	-0.0012
24	MIDF Amanah Strategic Fund	0.0255%	2.3231%	91.1408	1.0349	-0.0129	-0.0003	-0.0001
25	RHB Emerging Opportunity Unit Trust	2.4987%	38.1667%	15.2743	1.9266	0.0640	0.0127	0.0249
26	RHB Small Cap Opportunity Unit Trust	0.7388%	10.1454%	13.7319	0.5094	0.0673	0.0134	0.0070
27	RHB Smart Treasure Fund	0.3494%	5.6440%	16.1554	0.0480	0.0521	0.0612	0.0029
28	RHB Thematic Growth Fund	-0.1220%	2.1150%	-17.3344	-0.0516	-0.0839	0.0344	-0.0018
29	RHB Capital Fund	1.5578%	25.6193%	16.4457	1.2112	0.0586	0.0124	0.0153
30	RHB Dynamic Fund	1.4418%	22.5702%	15.6537	1.0742	0.0614	0.0129	0.0141
31	RHB Malaysia DIVA Fund	0.1362%	2.9327%	21.5349	0.0403	0.0275	0.0200	0.0008
32	TA Small Cap Fund	0.7987%	12.1500%	15.2116	0.5476	0.0612	0.0136	0.0076
	Average	**0.2152%**	**5.3046%**	**-85.0716**	**0.7350**	**-0.0172**	**-0.0202**	**0.0018**
	FBMKLCI	**0.0314%**	**1.3883%**	**44.2086**	**1.0000**	**-0.0174**	**-0.0002**	**0.0000**
	Malaysia T-Bills	**0.0606%**	**0.0029%**	**0.0473**	**0.0001**	**1.7747**	**0.5023**	**0.0001**

Table 4.2 shows the return, risk and performance measures for the conventional equity funds. The average weekly return for all the conventional equity funds is 0.2152%. RHB Emerging Opportunity Unit Trust carry the highest average return is with return of 2.4987%. In comparison, FBMKLCI benchmark's average weekly return is lower than the fund which is 0.0314%. On average, conventional equity

funds perform better than its market benchmark. This result is consistent to that reported by Chua (1985), Annuar et al. (1997), Ong (2000), Rozali and Abdullah (2006), and Bashir and Nawang (2011) as evidence on the outperformance of funds in Malaysia and the work of Ippolito (1993) and Swinkels and Rzezniczak (2009) in Western countries.

The fund's standard deviations range from 11.2841% to 38.1667% produces an average of 5.3046% as compared to the FBMKLCI's standard deviation which is 1.3883%. All of the conventional equity funds have higher standard deviations than the FBMKLCI benchmark. The fund with the highest standard deviation is RHB Emerging Opportunity Unit Trust with a value of 38.1667%. This fund's asset is invested mostly small to medium size companies and this resulted to a higher risk compared to the fund with diversified portfolio in in larger companies. Moreover, buy and sell in small and medium companies will involve longer time as the buyer and seller might not available easily as compared if trading in larger and established companies. Therefore, there is a possibility the shares will not be sold at or close the shares' fair value if there are lower volume traded for the shares.[2]In the fund's prospectus, the objective had stated that this fund is the right option for investors who fairly aggressive that willing to accept higher risk for higher growth of their capital.[3] As the fund has consistently outperformed its benchmark from 2011 to 2015, the fund has successfully achieved its objective. In terms of beta, 25 out of 32 funds are having lower beta than the FBMKLCI index of 1.0. The average value of beta is 0.7350, which is nearly to index 1.0. The Malaysian Treasury Bills has lower

[2] http://www.rhb.com.my
[3] http://www.rhbgroup.com

return which is consistent with its standard deviation and β or the systematic risk which are 0.0029% and 0.001 respectively.

Higher of Sharpe index result means the fund perform better than the market and in the future, it is likely for the funds to get high return and high risk. Since the value of FBMKLCI is -0.0174%, only 15 out of the 32 funds do better than the market index. The rest of the funds are underperforming the market and the lowest Sharpe value is Amanah Mutual Berhad Value Trust Fund and proved that this fund has weak performance. The fund that indicates the highest Sharpe measure is RHB Small Cap Opportunity Unit Trust with a Sharpe measure of 0.0614. While based on the Treynor measures, 15 out of the 32 funds are doing better than the FBMKLCI index which is -0.0002. The fund with the highest Treynor measure of 0.0612 is RHB Smart Treasure Fund. Jensen alpha's results demonstrate 14 out of the 32 funds are performing above the FBMKLCI benchmark. The different result from the three measurement tools is because Sharpe index includes systematic and unsystematic risks in the measurement of the total risks which whereas Treynor and Jensen alpha measure only measure the systematic risk in the calculation.

Table 4.3

Average Return and Total Risk (measured by Standard Deviation)

Coefficient of Variation and Beta Coefficient for Islamic Equity Funds

	Fund Name	Average Return (%)	AR Rank	Standard Deviation	SD Rank	Coefficient of Variation	CoV Rank	Beta
1	Amanah Mutual Berhad Dana Yakin	0.0032%	12	1.6451%	10	520.7159439	1	0.8803
2	PMB Dana Mutiara	-0.0418%	15	1.4365%	14	-34.3825446	15	0.2044
3	PMB Syariah Aggressive Fund	0.2753%	3	2.1192%	5	7.698042806	12	0.2812
4	PMB Syariah Dividend Fund	0.2958%	2	4.4300%	2	14.97426626	9	0.2682
5	Affin Islamic Equity Fund	-0.0102%	13	1.4017%	15	-137.831162	18	0.8513
6	KAF Dana Adib	0.0951%	6	1.3451%	17	14.14283408	10	0.8618
7	AmIslamic Growth Fund	0.1565%	4	1.4861%	12	9.496295444	11	0.9859
8	AmIttikal	0.0279%	11	1.4797%	13	53.07598828	2	0.9447
9	BIMB i-Growth Fund	0.0431%	9	1.3022%	18	30.20801095	4	0.8366
10	PMB Dana Al Aiman	-0.1211%	17	2.0575%	6	-16.9883979	13	0.0298
11	PMB Dana Bestari	0.5126%	1	8.6577%	1	16.8911679	7	0.5396
12	Eastspring Investments Dana al-Ilham	-0.0661%	16	3.4362%	4	-51.9528838	16	0.7956
13	Affin AIIMAN Growth Fund	0.0690%	8	1.6725%	9	24.23407345	5	0.8024
14	Inter-Pacific Asset Management - InterPac Dana Safi	0.0698%	7	1.3869%	16	19.87119719	6	0.6805
15	Kenanga Islamic Fund	0.1027%	5	1.5798%	11	15.37617647	8	0.9095
16	Kenanga Syariah Growth Fund	-0.1395%	18	4.3380%	3	-31.1008347	14	0.4954
17	MIDF Amanah Islamic Fund	-0.0305%	14	1.7771%	7	-58.327973	17	0.9803
18	RHB Dana Islam	0.0417%	10	1.7074%	8	40.93868906	3	0.9193
	FBMS	**0.0387%**		**1.4053%**		**36.34911193**		**1.0000**

Table 4.3 presents the summary of average weekly return obtained from estimating the return, total risk and coefficient of variation for Islamic equity funds from January 2011 until December 2015. The highest total risk is PMB Dana Bestari follow by PMB Syariah Dividend Fund and Kenanga Syariah Growth Fund. The plausible reason for the high total risk of PMB Dana Bestari is as the fund invests primarily 70% and 99.55% of its NAV in Shariah-compliant equity and equity-related securities in the equity market. Therefore, the fluctuation in stock market will directly influence the fund's level of risk. Some of the factors to the stock market fluctuation include interest rate, economic and political climate, and regulatory policies indirectly affect the NAV of the fund.[4]

BIMB i-Growth Fund have relatively low risk as its standard deviation is lower compared to other funds with value of 1.3022%. This is because the fund manager

[4] http://www.pmbinvest.com.my

adopts a temporary defensive strategy by raising cash portions between 40% to 50% of the fund’ s NAV in response to volatility in economic, political, and any other conditions. This event has dragged performance temporarily and resulted in a disparity between the fund and the FBMEMAS’s performance. As result, the fund failed to meet its objective to achieve capital appreciation during this 5 years period under review.[5] The FBMEMAS risk level is 1.4053% and it is found almost all Islamic equity funds have higher total risk than FBMEMAS benchmark.

Coefficient of variation measured comparative variability indicated by risk per unit return. It shows that Amanah Mutual Berhad Dana Yakin has the best risk-return trade-off followed by AmIttikal. The outperformance of the Amanah Mutual Berhad Dana Yakin was mainly due to fund manager’s capability to perform better in asset allocation and stock selection. The fund allocated a minimum 70% to maximum 98% of its asset in Shariah-compliant equities and minimum 2% in Shariah-compliant liquid assets. The fund manager focused on selected companies which provided goods and services with relatively resilient demand. The fund also had exposure to companies that were beneficiaries of a stronger US Dollar vis-à- vis Ringgit, higher construction spending, and rising crude palm oil (CPO) prices. Moreover, some of the fund’s asset is invested in high dividend yield companies as they are expected to provide relative stability during volatile market conditions. For the last five financial years (2010 to 2015), the fund’s compounded return was 30.68% while the FBMEMAS’s compounded return was only 18.64% for the same period. Thus, the fund successfully achieved its objective during the period review where the objective is to accomplish a stable capital growth over the medium term (three to five years) to

[5] https://www.fundsupermart.com.my/main/admin/buy/reports/annualreports.MYBIBIG.pdf

long-term period (more than five years). [6]On the other hand, Kenanga Syariah Growth Fund provides investors with negative return of -0.1395% but carry third highest in total risk of 4.3380%. This show a negative relationship between risk total risk and average return as it provides higher risk, but producing lower return. During 2012 until 2014, the fund had reduced the equity exposure from 94.1% to 70.0%.[7] Furthermore, the fund reduced exposure to the banking, telecommunication, and property sector and increases the investments in the oil & gas sector. The fall in the equity exposure is a result of the portfolio rebalancing exercise by the new designated fund manager, Mr. Chung Yee Wah. The internal restructuring were due to the retirement of the previous Chief Investment Officer, Ms. Lee Sook Yee. [8]

The study also found that all the funds have beta lower than 1, which means Islamic equity funds are less volatile than the market. Low betas are assumed to have relatively low sensitivity to the market changes.

[6] http://www.ambmutual.com.my/
[7] https://www.fundsupermart.com.my/
[8] www.KenangaInvestors.com.my

Table 4.4

Average Return and Total Risk (measured by Standard Deviation, Coefficient of Variation and Beta Coefficient for Conventional Equity Funds

Fund Name	Average Return (%)	AR Rank	Standard Deviation (%)	SD Rank	Coefficient of Variation	CoV Rank	Beta
1 Amanah Mutual Berhad Dividend Trust Fund	-0.0963%	27	2.2777%	15	-23.6640	24	0.5419
2 Amanah Mutual Berhad Ethical Trust Fund	-0.1265%	31	2.3057%	14	-18.2245	20	0.8699
3 Amanah Mutual Berhad Index-Linked Trust Fund	-0.0814%	26	1.7776%	20	-21.8326	21	0.9707
4 Amb SmallCap Trust Fund	0.0354%	14	1.6916%	22	47.7694	4	0.8702
5 Amb Unit Trust Fund	-0.0235%	21	1.5831%	23	-67.2681	28	0.7809
6 Amanah Mutual Berhad Value Trust Fund	-0.2096%	32	2.3505%	12	-11.2152	18	0.8071
7 PMB Shariah Mid-Cap Fund	-0.0554%	24	1.2841%	32	-23.1894	23	0.1455
8 Affin Hwang Equity Fund	-0.0005%	18	1.3307%	31	-2544.3216	32	0.7772
9 KAF Core Income Fund	-0.0087%	19	1.4596%	25	-168.2167	31	0.6579
10 Alliance Tactical Growth Fund	-0.0435%	23	1.8128%	19	-41.7116	27	1.1125
11 Alliance Vision Fund	0.0698%	9	3.2060%	10	45.9322	5	0.7779
12 AmDividend Income	0.0825%	8	1.4289%	26	17.3226	11	0.8702
13 Areca Capital - Areca EquityTrust Fund	0.0175%	17	1.9061%	17	108.8267	1	0.7984
14 CIMB-Principal Equity Aggressive Fund 3	0.0612%	12	1.3917%	28	22.7468	7	0.8840
15 Eastspring Investments Equity Income Fund	0.0463%	13	1.3671%	30	29.5309	6	0.6783
16 Eastspring Investments Growth Fund	-0.1175%	28	3.5407%	9	-30.1454	25	1.0317
17 Eastspring Investments Small Cap Fund	-0.1219%	29	4.9572%	7	-40.6699	26	0.0022
18 Inter-Pacific Asset Management - InterPac Dynamic Equity Fund	0.0698%	10	1.3869%	29	19.8712	10	0.6206
19 RHB KLCI Tracker Fund	0.0619%	11	1.4014%	27	22.6383	8	1.0054
20 Kenanga Growth Fund	-0.0265%	22	4.3882%	8	-165.8375	30	0.4987
21 Kenanga Premier Fund	0.0239%	16	1.5676%	24	65.6315	3	0.8369
22 MIDF Amanah Dynamic Fund	-0.0169%	20	1.8919%	18	-111.7234	29	0.8449
23 MIDF Amanah Growth Fund	-0.0794%	25	1.7742%	21	-22.3545	22	0.7969
24 MIDF Amanah Growth Fund	0.0255%	15	2.3231%	13	91.1408	2	1.0349
25 RHB Emerging Opportunity Unit Trust	2.4987%	1	38.1667%	1	15.2743	15	1.9266
26 RHB Small Cap Opportunity Unit Trust	0.7388%	5	10.1454%	5	13.7319	17	0.5094
27 RHB Smart Treasure Fund	0.3494%	6	5.6440%	6	16.1554	13	0.0480
28 RHB Thematic Growth Fund	-0.1220%	30	2.1150%	16	-17.3344	19	-0.0516
29 RHB Capital Fund	1.5578%	2	25.6193%	2	16.4457	12	1.2112
30 RHB Dynamic Fund	1.4418%	3	22.5702%	3	15.6537	14	1.0742
31 RHB Malaysia DIVA Fund	0.1362%	7	2.9327%	11	21.5349	9	0.0403
32 TA Small Cap Fund	0.7987%	4	12.1500%	4	15.2116	16	0.5476
FBMKLCI	**0.0314%**		**1.3883%**		**44.2086**		**1.0000**

Table 4.4 presents the summary of average weekly return obtain from estimating the return, total risk and coefficient of variation for conventional equity funds for the period of January 2011 until December 2015. The results shows 25 out of 32 conventional equity funds have beta as lower than 1. It is observable that the ranges beta of the conventional equity funds is from -0.0516 to 1.9266, which shows majority of the funds are less risky than the market. The highest beta is RHB Emerging Opportunity Unit Trust fund with 1.9266.

Standard deviation will be a base to calculate the total internal risk of funds. It shows that for the period of 2011 until 2015, RHB Emerging Opportunity Unit Trust carry the highest total risk followed by RHB Capital Fund and RHB Dynamic Fund. PMB Shariah Mid-Cap Fund has relatively low risk as compared to other funds by 1.2841%. The FBMKLCI market risk level is 1.3883%. However, the results show almost all the funds have higher internal risk than market index.

The lower the ratio of standard deviation to return implies the better the risk-return trade-off. The analysis results show the best risk-return trade-off is Areca Capital - Areca EquityTrust Fund, followed by MIDF Amanah Growth Fund. RHB Emerging Opportunity Unit Trust that carries the highest total risk is ranking number fifteen in the coefficient of variation result. As can be seen, RHB Emerging Opportunity Unit Trust provides investors with the highest average return as well as highest total risk.

Table 4.5

Average Returns and Risks Profiles of Islamic and Conventional equity funds for 5 Years (January 2011 to December 2015)

	Average Return (%)	Standard Deviation (%)	Beta	Sharpe	Treynor	Jensen
Islamic Equity Funds	0.0713%	2.4033%	0.6815	-0.0023	-0.0025	0.0003
No. of Funds :						
> market	10 (56%)	14 (78%)	0 (0%)	10 (56%)	10 (56%)	10 (56%)
< market	8 (44%)	4 (22%)	18 (100%)	8 (44%)	8 (44%)	8 (44%)
Market (FBMS)	**0.0387%**	**1.4053%**	**1.0000**	**-0.0120**	**-0.0002**	**0.0000**
Conventional Equity Fund	0.2152%	5.3046%	0.7350	-0.0172	-0.0202	0.00177385
No. of Funds :						
> market	14 (44%)	28 (88%)	7 (22%)	15 (47%)	15 (47%)	14 (44%)
< market	18 (56%)	4 (12%)	25 (78%)	17 (53%)	17 (53%)	18 (56%)
Market (FBMKLCI)	**0.0314%**	**1.3883%**	**1.0000**	**-0.0174**	**-0.0002**	**0.0000**
Malaysia T-Bills	**0.0606%**	**0.0029%**				

Table 4.5 below shows average returns and risks profiles of Islamic and Conventional equity funds for 60-month period from January 2011 to December

2015. It shows that the average returns of 10 out of 18 Islamic equity funds were above the FBMEMAS's market returns. Meanwhile, 14 out of 32 or 44% of conventional equity funds able to beat the FBMKLCI's market returns. Generally, the average returns of both Islamic and conventional equity funds outperform to their respective market benchmarks and to the risk-free Treasury bill's average return of 0.0606%.

For the risk distribution, it shows that the Islamic equity funds are having a greater average standard deviation of 2.4033% compared to the market of 1.4053%. 22% or 4 funds carry a standard deviation that is below the market. Thus, Islamic equity funds' weekly returns have greater volatility than the market. On the other hand, conventional equity funds carry a standard deviation of 5.3046% which is considerably higher than the market's standard deviation of 1.3883 %. There is only 12% of the conventional equity funds have lower standard deviation compared to the market. This signifies that both types of funds have a larger volatility of weekly returns than the market portfolio.

Systematic risk influence to the funds is represented by beta. On average, both Islamic equity funds and conventional have a betas value of is lower than the market of 1.0 which yielded 0.6815 and 0.7350 respectively. Therefore there is only a small difference of beta between these two group funds. However, individually, 100% of Islamic equity funds and 78% of conventional equity funds carry a lower beta value than markets. Therefore, almost all of funds under study were less risky than their respective market. To recap, Systematic risk is the uncertainty that affect the whole stock exchange industry in which it consists of the daily fluctuations in a stock's price.[9] Political and governmental policies, economic changes, regulatory changes and interest rates movement are some of the factors that will cause movements in the prices of security and then fluctuate the NAV of the units.[10]

Based on the analysis of the three performance indicators, on average conventional equity trust funds were unable to outperform the markets, whereas, the Islamic equity funds are capable outperform the market on average. On the individual fund basis, 56% or 10 out of 18 Islamic equity funds beat the FBMEMAS market while only 47% of conventional equity funds outperforming the FBMKLCI. Nonetheless, the conventional equity funds appeared to experience a bit lower performance than the FBMKLCI since more than 50% of its individual funds were incapable to beat the market in the three indices. It is suggested that different performance measure will generate different results in fund's performance. Jensen's (1968) by applying the capital asset pricing model CAPM determine the abnormal return of a portfolio over the theoretical expected return. Treynor's (1965) reward-to-volatility ratio (RVOL) distinguished the total risk and systematic risk indirectly and assumes that portfolios are diversified enough and thus ignores any diversifiable risk. Treynor ratios are commonly used to rank fund managers. The ranking given by Treynor ratios is usually the same as the ranking obtained via Jensen's alpha because both of them rely on systematic risk. Alternatively, Sharpe's (1966) was used to calculate the risk-adjusted returns if total variability was thought to be the appropriate measure of risk. Both Treynor index and Sharpe index remove the element of only considering return as a measure of performance. However, there is no independent ratio of the time period over which it is measured which means the ratio can change and different

[9] www.investopedia.com/terms/s/systematicrisk.asp
[10] http://www.midf.com.my

results will be generated from one period to another (Hodges, Taylor, and Yoder, 1997).

Table 4.6
Differences in Average Risks of Islamic and Conventional Equity Funds

Fund	Average Return (%)	Average Standard Deviation (%)	Average Coefficient of Variation	Average Beta
Islamic Equity Funds	0.0713%	2.4033%	24.2799	0.6815
Conventional Equity Fund	0.2152%	5.3046%	-85.0716	0.7350

Table 4.6 presents the differences in average risks of Islamic and conventional equity funds. The table shows that Islamic equity funds' average returns are less risky than the conventional equity funds. From 2011 till 2015, Islamic equity funds' average standard deviation of returns is 2.4033% is lower if compared with conventional equity funds which is 5.3046%. In terms of the coefficients of variations, Islamic equity funds carry 24.2799 values while conventional equity funds carry -85.0716 values respectively. This reveals there is a .greater differences in risk between both types of funds.

In terms of the beta values, Islamic equity funds shows 0.6815 result while conventional equity shows 0.7350 result and both funds have a lower beta compared to the market beta of 1.0. Therefore, Islamic equity funds are less sensitive to market's changes as than conventional equity funds. This result is not unexpected due to the fact Islamic equity funds are limited to finance its asset in Shariah compliant instruments only. For the overall risks data, Islamic equity funds were less risky than both the conventional equity funds and market benchmark.

Table 4.7
Islamic and Conventional Equity Funds Performance Ranking

Islamic Equity Funds

Rank	Treynor		Jensen	
1	PMB Syariah Dividend Fund	0.008959574	PMB Dana Bestari	0.004661284
2	PMB Dana Bestari	0.008469575	PMB Syariah Dividend Fund	0.002551965
3	PMB Syariah Aggressive Fund	0.007815377	PMB Syariah Aggressive Fund	0.002244991
4	AmIslamic Growth Fund	0.001024023	AmIslamic Growth Fund	0.001175949
5	Kenanga Islamic Fund	0.000518993	KAF Dana Adib	0.000874364
6	KAF Dana Adib	0.000459195	Kenanga Islamic Fund	0.000625508
7	Inter-Pacific Asset Management - InterPac Dana Safi	0.000209477	Affin AIIMAN Growth Fund	0.000270156
8	Affin AIIMAN Growth Fund	0.000167939	Inter-Pacific Asset Management - InterPac Dana Safi	0.000257384
9	BIMB i-Growth Fund	-0.000148583	BIMB i-Growth Fund	1.68777E-05
10	RHB Dana Islam	-0.000150452	RHB Dana Islam	1.68295E-05
11	AmIttikal	-0.000292804	AmIttikal	-0.00011718
12	Amanah Mutual Berhad Dana Yakin	-0.000594996	Affin Islamic Equity Fund	-0.000184293
13	Affin Islamic Equity Fund	-0.00077187	Amanah Mutual Berhad Dana Yakin	-0.000375226
14	MIDF Amanah Islamic Fund	-0.000877389	MIDF Amanah Islamic Fund	-0.000694637
15	Eastspring Investments Dana al-Ilham	-0.001529377	PMB Dana Mutiara	-0.000938681
16	Kenanga Syariah Growth Fund	-0.003936809	Eastspring Investments Dana al-Ilham	-0.001082528
17	PMB Dana Mutiara	-0.004761043	PMB Dana Al Aiman	-0.001761483
18	PMB Dana Al Aiman	-0.059241055	Kenanga Syariah Growth Fund	-0.001866605

Conventional Equity Funds

Rank	Treynor		Jensen	
1	RHB Smart Treasure Fund	0.061228228	RHB Emerging Opportunity Unit Trust	0.024897068
2	RHB Thematic Growth Fund	0.034408243	RHB Capital Fund	0.015315103
3	RHB Malaysia DIVA Fund	0.020014723	RHB Dynamic Fund	0.014122328
4	TA Small Cap Fund	0.013571594	TA Small Cap Fund	0.007564097
5	RHB Small Cap Opportunity Unit Trust	0.013413195	RHB Small Cap Opportunity Unit Trust	0.006955768
6	RHB Dynamic Fund	0.012905418	RHB Smart Treasure Fund	0.00294974
7	RHB Emerging Opportunity Unit Trust	0.012681424	RHB Malaysia DIVA Fund	0.000816175
8	RHB Capital Fund	0.012403066	AmDividend Income	0.000479536
9	AmDividend Income	0.000309727	Alliance Vision Fund	0.000330351
10	Inter-Pacific Asset Management - InterPac Dynamic Equity Fund	0.000229685	RHB KLCI Tracker Fund	0.000306325
11	Alliance Vision Fund	0.000183308	Inter-Pacific Asset Management - InterPac Dynamic Equity Fund	0.000292325
12	CIMB-Principal Equity Aggressive Fund 3	6.38274E-05	CIMB-Principal Equity Aggressive Fund 3	0.000269768
13	RHB KLCI Tracker Fund	6.33349E-05	Eastspring Investments Equity Income Fund	7.12553E-05
14	Eastspring Investments Equity Income Fund	-0.000136286	Amb SmallCap Trust Fund	8.74734E-06

15	Amb SmallCap Trust Fund	-0.000231287	MIDF Amanah Strategic Fund	-5.07195E-05
16	MIDF Amanah Strategic Fund	-0.000290348	Kenanga Premier Fund	-0.000114545
17	Kenanga Premier Fund	-0.000378205	Areca Capital - Areca EquityTrust Fund	-0.000187535
18	Areca Capital - Areca EquityTrust Fund	-0.000476219	Affin Hwang Equity Fund	-0.000373043
19	Affin Hwang Equity Fund	-0.000721324	KAF Core Income Fund	-0.000483385
20	MIDF Amanah Dynamic Fund	-0.000857745	MIDF Amanah Dynamic Fund	-0.000520805
21	Alliance Tactical Growth Fund	-0.000889896	Amb Unit Trust Fund	-0.000602247
22	KAF Core Income Fund	-0.000976124	Kenanga Growth Fund	-0.000699643
23	Amb Unit Trust Fund	-0.001012514	Alliance Tactical Growth Fund	-0.000721498
24	Amanah Mutual Berhad Index-Linked Trust Fund	-0.001410936	PMB Shariah Mid-Cap Fund	-0.001074029
25	Kenanga Growth Fund	-0.001644396	Amanah Mutual Berhad Index-Linked Trust Fund	-0.001135304
26	Eastspring Investments Growth Fund	-0.001676755	MIDF Amanah Growth Fund	-0.001156716
27	MIDF Amanah Growth Fund	-0.001692949	Amanah Mutual Berhad Dividend Trust Fund	-0.00138713
28	Amanah Mutual Berhad Ethical Trust Fund	-0.002092828	Eastspring Investments Growth Fund	-0.00148092
29	Amanah Mutual Berhad Dividend Trust Fund	-0.002801086	Amanah Mutual Berhad Ethical Trust Fund	-0.001610585
30	Amanah Mutual Berhad Value Trust Fund	-0.003284718	Eastspring Investments Small Cap Fund	-0.001773036
31	PMB Shariah Mid-Cap Fund	-0.007624059	RHB Thematic Growth Fund	-0.001787937
32	Eastspring Investments Small Cap Fund	-0.800167669	Amanah Mutual Berhad Value Trust Fund	-0.002456433

Table 4.7 above shows the summary of fund performance ranking for 18 Islamic and 32 conventional equity funds. The funds are rank based on the Treynor and Jensen alpha's indices performance measure. This is because Treynor simply uses systematic risk in the computation which it assumes that the portfolio is well diversified already. Jensen alpha compute risk premiums in terms of beta (systematic risk) and for that rationale also it assume the portfolio is also well diversified. Therefore, these two performance measures are best applied with diversified portfolios, like mutual funds.

For Islamic equity fund and based on Treynor index, PMB Syariah Dividend Fund ranks first with average return of 0.2958%. The funds' strategy to invest into specific small to mid-cap for growth outperformance while timely selective big-cap index-linked stocks for indexation and dividend yield play is the reason for the outperformance throughout the 5 years evaluation. On the other hand, PMB Dana Al

Aiman rank last with -0.1211% returns. The fund underperformed due to asset allocation and stock selection. The fund had tactically raised some cash ahead of market volatility and the return generated form the money market are far below due to the lower interest rates by bank. Moreover, the laggards in the fund were Malaysia Airports Holdings Berhad, Bursa Malaysia Berhad, and MISC Berhad. Based on Jensen alpha, PMB Dana Bestari ranks first with highest average return, followed by PMB Syariah Dividend Fund with 0.5126%. Throughout the period review, PMB Dana Bestari focus on investing its asset into undervalued companies including companies that provide good and services that have relatively resilient demand, beneficiaries of higher construction spending, beneficiaries of stronger Crude Palm Oil (CPO) prices, and companies that offer attractive dividend yield. Therefore, the results indicate that PMB Syariah Dividend Fund and PMB Dana Bestari consistently have the higher return during the period study.

As for conventional equity funds, RHB Smart Treasure Fund ranks the first while Eastspring Investments Small Cap Fund ranks the last on risk adjusted measure of Treynor index. The reason for the good performance of RHB Smart Treasure Fund is that the fund is an aggressive growth fund type which invests in high-risk/high-return stocks or in companies that show high growth prospects. The portfolio contains around 50 stocks at any time. The largest 10 stocks account for around 40% of the fund and the top 30 stocks around 80%. Digi Communication, Maybank Berhad, Cimb Bank Berhad, Topglove Corporation Berhad, CI Holdings and NESTLE Berhad have all been significant contributors to the fund's outperformance. Meanwhile, based on Jensen alpha, RHB Emerging Opportunity Unit Trust ranks first and Amanah Mutual Berhad Value Trust Fund ranks last. RHB Emerging Opportunity Unit Trust is a fairly aggressive fund that focus on active value trading of 95%-98% of the NAV to the large companies with market capitalization of more than RM750 million. Genting Plantations Berhad, Time Dotcom Berhad, Tenaga Nasional Berhad and Oldtown Berhad are the companies are the companies in the fund's portfolio that show long term earnings generation visibility, new capacity and market expansions, besides of the strong balance sheet and cash flows. On the other hand, Amanah Mutual Berhad Value Trust Fund ranks last due to defensive strategy both in terms of cash holdings and stock selections to hedge the unexpected event such the low foreign shareholdings, undemanding valuation, weakness in the Ringgit and commodity prices.

4.3 Summary of Findings

This paper examines the comparative performance of Islamic and conventional equity fund in Malaysia and to see if the funds perform superior or inferior compared to their respective market benchmarks for 5 years period from year 2011 to 2015 by using weekly Net Asset Value (NAV) collected from the Bloomberg Terminal. The Islamic and conventional equity funds under consideration are ranked on the basis of their average returns, coefficient of variation, standard deviation and Sharpe, Treynor and Jensen alpha measures.

In terms of the average weekly returns, Islamic equity funds were poorer when compared to conventional equity funds because they failed to beat the conventional equity funds' performance. The highest average return for conventional equity fund is 2.4987% from the RHB Emerging Opportunity Unit Trust. While the highest average return for Islamic equity fund is only 0.5126% from the PMB Dana Bestari.

Overall, 10 out of 18 Islamic equity funds and 14 out of 32 conventional equity funds performing above respective market return.

The Islamic equity funds exhibited only a slightly better performance than the FBMEMAS's performance. This results of Islamic funds' performance support the results of Yaccob, Karim and Khalid (2015), Rahman et al. (2012), Mansor and Bhatti (2011), Hoepner, Rammal and Rezec (2009), Fikriyah et al. (2007), Rozali and Abdullah (2006) that the Islamic funds have better performance than the market. On the other hand, conventional equity funds failed to beat its market benchmark of FBMKLCI throughout the 5-years period. It is support studies by Tan (1995), Mohamed and Mohd Nasir (1995), Lee (1993) and other global studies by Sharpe (1966) and Treynor (1966) that the unit trust examined was underperformed the market benchmark.

Almost all the Islamic and conventional equity funds showed higher total risk (standard deviation of return) compared to their respective FBMEMAS and FBMKLCI. There is a positive relationship between the risk (Standard Deviation) and average return by PMB Dana Bestari from the sample of Islamic equity funds. Meanwhile, a positive relationship between the risk (Standard Deviation) and average return by RHB Emerging Opportunity Unit Trust from the sample of conventional equity funds. These indicate that both funds provide their investors relatively higher return with the higher risk. If comparison made between Islamic and conventional equity, conventional equity fund carry higher total risk (standard deviation of return) than Islamic equity fund. Therefore, in terms of total risk (standard deviation of return), it is concluded that conventional equity fund more risky.

The highest value of Sharpe ratio for Islamic equity fund is 0.1037 from PMB Syariah Aggressive Fund and for conventional equity fund is 0.0673 % RHB Small Cap Opportunity Unit Trust. The higher Treynor ratio measured means the fund has greater excess return being generated by the fund. The highest value of Treynor ratio for Islamic equity fund is 0.009% from PMB Syariah Dividend Fund and for conventional equity fund is 0.0612% from RHB Smart Treasure Fund. If the value is positive of Jensen alpha, then the portfolio is earning a proper excess returns with the risk it associated with. Accordingly, this positive value shows that the fund manager has a good stock selection skills as it outperform the market performance. In other words, a positive value for Jensen alpha's alpha means a fund manager has "beat the market" with his stock selection skills. The highest value of Jensen alpha for Islamic equity fund is 0.0047% from PMB Dana Bestari and for conventional equity fund is 0.0248% from RHB Emerging Opportunity Unit Trust.

CHAPTER 5

CONCLUSION

5.1 Introduction

This chapter concludes the whole research. It begins with a summary of the study. This is followed by implication of the study, the limitations, and, recommendations for future research.

5.2 Summary of the Study

This paper examines the comparative performance of Malaysian Islamic and conventional equity funds from January 2011 until December 2015. There are two objectives of this study. The first objective is to examine the returns performance of both type of funds and evaluating it against composite and Shariah benchmarks. The second objective is to examine the difference in performance of risk and return between the two types of funds. This research conveys comparative performance evidence of 18 Islamic and 32 conventional equity funds for 5 years period by using weekly data observations.

The findings show that Islamic equity funds performing better against its respective Shariah benchmarks while conventional equity funds failed to beat its composite benchmark over the 5 years period. Of the two types of equity funds under investigation, the finding also indicates in terms of the return performance, conventional equity funds perform better than Islamic equity funds. This result consistent with Merdad et al. (2010), Abdullah, Hassan, & Mohamad (2007) and

Kraussl & Hayat (2008) that claims the conventional funds beat the Islamic fund's performance during period under review.

This study finds for PMB Dana Bestari from Islamic equity funds and RHB Emerging Opportunity Unit Trust for conventional equity funds show the best return performance amongst the total funds and outperforms their market benchmark. In terms of risk, conventional equity funds carry standard deviation that is higher than those of Islamic equity funds. It is observed that the standard deviation of the two groups varies widely. Thus, it can be said that Islamic equity funds are less risky than conventional equity funds. Based on the individual risk adjusted performance measures of Jensen's alpha, Treynor index and Sharpe index, majority of all the funds shows negative values throughout the study period. In addition, on average, none of the Islamic equity funds were able to outclass the conventional equity funds.

These findings provide further supports to the earlier studies of Yaccob, Karim and Khalid (2015), Rahman et al. (2012), Mansor and Bhatti (2011), Hoepner, Rammal and Rezec (2009), Fikriyah et al. (2007), Rozali and Abdullah (2006) that the Islamic equity funds outperforming the FBMEMAS market. As for conventional equity funds' result that was underperformed the FBMKLCI market benchmark, it is consistent with those of Lee (1993), Mohamed and Mohd Nasir (1995), Tan (1995), and other international studies by Treynor (1966) and Sharpe (1966).

As this study was analyzed from the year 2011 to year 2015, it should also be noted that this period does not consists of various sub periods with different economic conditions such Asian Financial Crisis (1998), bullish stock market (2005-2007) and a severe financial crisis in the year 2008 following the post-election violence. Thus, our results may have been contradicting with the results from previous studies as most of the earlier research resides the various economic cycles. Hence, caution needs to be exercised in interpreting the results.

In short, from the results accessible, it can be said that conventional equity funds performance in terms of the fund's return is slightly more attractive to investors than the Islamic equity funds. However, obviously for a Muslim, they need to invest in accordance with the requirements of Islamic law, thus the primary benefit of investing in Islamic equity fund is assurance that the funds are purchasing only Shariah-compliant stocks. As there are increasing number of launched Shariah-compliant funds in Malaysia, investors have many available choices that they can tailor a portfolio to meet their investment objective. However, even the Islamic equity fund's performance failed to beat conventional equity funds the span for growth is there and sooner or later the development in Islamic equity funds performance will be seen. Nevertheless, this study provides a result that is based on past performance of the funds and thus the investors should be aware that is not certainly a guide to the future performance. On the other hand, with a low risks portfolio, Islamic equity funds could be an outstanding investment option for investors who seek safety measures and morally aware. Finally, the low betas of Islamic equity funds in general with respect to both Islamic and conventional market indices make Islamic equity funds a smart alternative for investors whose is risk averse as well as for any fund manager during market recession and economic volatility.

5.3 Implications of the Study

This study observes significant results on the performance of Islamic equity funds and conventional equity funds, which indicates that result of this study could benefit fund managers i.e. Employee Provident Fund (EPF), Permodalan Nasional Berhad, insurance or Takaful companies and unit trust companies in their asset allocation strategy and decision making on which funds to be included in their portfolio to improve their portfolio investments.

Bursa Malaysia and Securities Commission as the regulators of unit trust industry could also benefit from this study as the finding might assist in strengthening the unit trust fund industries by improving the existing policies on promoting equity funds among institutional and retail investors. Islamic funds especially should be promoted widely as it offers opportunity for diversification of the portfolios for the investors. As a consequence, this benefits the market in general.

The findings of this study also have significant useful effects for the investor. They are able to strategize their portfolio accordingly since this study offers information and prior knowledge to the investors which equity fund is the best performer in terms of the risk and return performance to match with investors' preferred level of risk. Furthermore, the detailed volatility pattern in returns can benefits investors in supervising the risk level and also optimizing their portfolio.

5.4 Limitations

The limitation of this study refers to the number of observations used. As the study only focuses on the current period which is from 2011 to 2015, the result might be more reliable if a longer time period is analysed. In addition, this study does not take into consideration the performance of unit trust funds before and after the crisis period due to time constraint. The sample size for this study is only focusing on equity funds, which are 18 Islamic and 32 conventional equity funds. Due to the sample are only taken from domestically invested equity funds, the results can represents a large sample of Malaysian Islamic and conventional domestic equity funds, but cannot represent Islamic equity funds' performance internationally. Thus, it should interpret with carefulness when a making suggestion to the bigger Islamic funds market.

5.5 Recommendations for Further Research

The study examines a comparative performance between Islamic and conventional equity funds based on market benchmark. Further studies are recommended to make a comparison on the performance of both types of funds between emerging and developed markets. Moreover, the longer time horizon can be put into consideration in order to make a better comparison on the performance before crisis, during crisis and after crisis of both types of equity funds. It is also recommended that a larger sample funds will be input into the study and different benchmark should be used. Future study van also utilize other performance measurement tools besides Sharpe index, Treynor index and Jensen alpha such as Henriksson and Merton's model which to observe the stock selection skills and market timing ability of fund manager or using Snail Trail Approach to measure fund manager's performance. Furthermore, a comparison of the performance of the Islamic and conventional equity funds throughout different incident capital market crisis would also be educational to the literature as it enables more convincing findings.

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APPENDICES

FAQS

Frequently-Asked Questions on Revised Shariah Screening Methodology

1. Why has the Securities Commission Malaysia's (SC) Shariah Advisory Council (SAC) revised the Shariah screening methodology for companies listed and to be listed on Bursa Malaysia?

In 1995, the SC's SAC established the methodology to undertake Shariah screening process for listed companies. The methodology comprises quantitative and qualitative assessments.In view of the current development and sophistication of the Islamic finance industry, the screening methodology has now been revised by adopting a two-tier approach to the quantitative assessment which applies the business activity benchmarks and the newly-introduced financial ratio benchmarks while at the same time maintaining the qualitative assessment.This revision is in line with the SC's initiatives to further build scale in the Shariah-compliant equity and investment management segments as well as expand the Islamic capital market's (ICM) international reach, as outlined in the Capital Market Masterplan 2.

2. What are the changes in the Shariah screening methodology?

The changes are as follows:

Quantitative Assessment	Revised Shariah Screening Methodology	Current Shariah Screening Methodology
Business activity benchmarks	5% 20%	5% 10% 20% 25%
Financial ratio benchmarks	33%	Not Applicable

Business Activity Benchmarks

The 5% benchmark would be applicable to the following business activities:

conventional banking;

conventional insurance;

gambling;

liquor and liquor-related activities;

pork and pork-related activities;
non-halal food and beverages;
Shariah non-compliant entertainment;
interest income from conventional accounts and instruments;
tobacco and tobacco-related activities; and
other activities deemed non-compliant according to Shariah.
The 20% benchmark would be applicable to the following activities:
hotel and resort operations;
share trading;
stockbroking business;
rental received from Shariah non-compliant activities; and
other activities deemed non-compliant according to Shariah.
The contribution of Shariah non-compliant activities to the overall revenue and profit before tax of the company will be calculated and compared against the relevant business activity benchmarks.
Note:
Current Shariah screening methodology:

Benchmark	Activity
5%	Conventional banking; Conventional insurance; Gambling; Liquor and liquor-related activities; Pork and pork-related activities; Non-halal food and beverages; Shariah non-compliant entertainment; and other activities deemed non-compliant according to Shariah
10%	Interest income from conventional accounts and instruments; Tobacco and tobacco-related activities; and other activities deemed non-compliant according to Shariah
20%	Rental received from Shariah non-compliant activities; and other activities deemed non-compliant according to Shariah
25%	Hotel and resort operations; Share trading; Stockbroking business; and other activities deemed non-compliant according to Shariah

Financial Ratio Benchmarks
The financial ratios applied are as follows:

i) Cash over Total Assets

Cash will only include cash placed in conventional accounts and instruments, whereas cash placed in Islamic accounts and instruments will be excluded from the calculation.

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CAPITAL MARKETS CHECKLISTS

Islamic Equity Funds

"Economics, as it has been practised in the last three decades, has been positively harmful for most people." Ha-Joon Chang

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Checklist Description

This checklist describes Islamic equity funds, where investors earn *halal* profits in strict conformity with the precepts of *sharia*

Definition

Islamic equity funds (IEFs) are similar to traditional equity funds in that investors pool their funds to invest in shares. However, main difference between IEFs and standard equity funds is that investors in IEFs earn halal profits in strict conformity with the precepts of Islamic *shariah*.

Returns are achieved largely through the capital gains earned by purchasing shares and selling them when their price increas Profits are also achieved from the dividends distributed by the relevant companies.

Of course, these funds are not allowed to invest in certain areas. They cannot, for example, invest in companies involved in a that are not lawful in terms of *shariah*, such as alcohol, gambling, or pornography. They also have a restricted ability to invest i areas such as financial companies and fixed-income securities, due to the *shariah* ban on usury. These funds generally avoid and other interest-bearing securities, while seeking protection against inflation by making long-term equity investments.

The first IEF was the Amana Income Fund, established in June 1986 by members of the North American Islamic Trust, the his Islamic equivalent of an American trust or endowment, serving Muslims in the United States and their institutions. The fund is existence today. Prior to the growth of IEFs, few investment alternatives were available to Muslim investors.

A wide variety of investment managers, including major financial institutions, now offer these funds. Examples include Citibanl Deutsche Bank, HSBC, Merrill Lynch, and UBS. Following the growth of IEFs, credible equity benchmarks have been establis including the Dow Jones Islamic Market (DJIM) index and the FTSE Global Islamic Index Series.

Fund managers can use indices such as the DJIM index to screen stocks. The DJIM tracks *shariah*-compliant stocks from arc the world. It eliminates those that fail to meet *shariah* guidelines, including financial ratio filters.

The Islamic equity funds industry had grown to around US$20 billion in assets under management by February 2008, accordi Failaka Advisors, a fund-monitoring company. Failaka Advisors said that the IEFs had grown rapidly, tripling over the previous years, driven by Gulf Cooperation Council investors. Saudi Arabian funds and fund managers dominate the industry, accountin nearly 75 funds out of around 300 IEFs worldwide. Bahrain has become the favored center for fund registrations in the Gulf.

Advantages

- These funds have obvious advantages to Muslims, who can invest their money safe in the knowledge that the fund will n compromise any of their religious beliefs.
- Many funds have been around for a long time and have a good track record of generating healthy returns for their investo
- It can be argued that, over the long term, IEFs will tend to perform better than conventional funds, since the former avoid investing in heavily leveraged companies.

Disadvantages

- The restricted ability of IEFs to invest in certain market sectors limits opportunities and may increase the risk of losses du economic downturns.

- Since Islamic principles preclude the use of interest-paying instruments, the IEFs do not maximize current income becau reserves remain in cash.
- Most of the funds target high net-worth individuals and corporate institutions, rather than the small investor. Minimum investments range from US$50,000 to as high as US$1 million.

Action Checklist

- As with traditional equity funds, the value of an IEF rises and falls as the value of the stocks in which the fund invests goe and down. Therefore, only consider investing in an IEF if you are willing to accept the risk that you may lose money
- Research sites that monitor the performance of IEFs to ascertain which fund is most likely to suit your needs and which h performed the best over a number of years. However, remember that past performance does not necessarily provide a gu how well the fund will perform in the future.

Dos and Don'ts

Do

- Analyze these funds in the same way as you would any other equity investment. Ask yourself whether you are looking fo income or capital gain and whether you are prepared to tie up your money for a long period—most investment managers believe that anyone investing in an equity fund should be prepared to commit for at least five years.
- Ask yourself whether you are prepared to accept the risk involved in investing in equities—stocks go down as well as up.

Don't

- Don't invest without exploring the wide range of funds on the market to find out which is best suited to your needs.
- Don't invest without consulting an independent financial adviser. However, make sure that they are truly independent and earn a commission by recommending clients to a certain fund.

Further reading

Books:

Ayub, Muhammad. *Understanding Islamic Finance*. Chichester, UK: Wiley, 2007.

Siddiqi, Adnan, and Peter Hrubi. *Islamic Investments Funds Versus Hedge Funds*. Munich, Germany: Grin Verlag, 2008.

Amana Mutual Funds Trust

Halal Investing

Halal investing requires investment decisions to be made in accordance with Islamic principles. As a faith-based approach to investment management, investors often consider *Halal* investing to be a category of ethical or socially responsible investing.

Islamic principles require that investors share in profit and loss, that they receive no interest (*riba*), and that they do not invest in a business that is prohibited by Islamic law, or *sharia*. Before investing in a company, it is necessary to evaluate its business activities and financial records to determine where its primary revenue comes from and how its income and expenditures are managed. A company that meets certain criteria would be *Halal*, or permissible. If it does not meet the criteria, it would be *haram*, or not permitted.

Interpretation of Islamic law as applied to business activities is nuanced, and halal investment guidelines can vary. Therefore, Muslim investors often rely on guidance from Islamic scholars to help determine whether an investment is *Halal*.

Investments that *sharia* scholars universally consider unacceptable are companies whose primary business activities violate the core tenets of Islam, including the manufacture or marketing of alcohol; gambling or gaming activities; conventional interest-based financial services; pork and pork products; and pornography. In addition, most *sharia* scholars advise against investing in tobacco companies.

Islamic scholars have established financial guidelines to determine when a business activity is a core source of revenue and when it is not. For example, the five percent rule says that a core business activity is one that accounts for more than five percent of a company's revenue, or gross income. This reasoning applies to the Islamic prohibition on *riba*, or interest, as well. If a company's interest-based income or holdings exceed certain limits, then investing in the company is forbidden.

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giving that can help you cleanse impure investment income by giving it away to acceptable charitable causes.
For more information on zakah, and how Saturna Capital can help, please refer to our *Zakah* page.

Halal Investment Screening

Halal investment screens help assess whether a company's business activities are *Halal* or *haram*. The screens facilitate the elimination of *haram* investments from consideration.

Halal investing screens seek to eliminate

- bonds and other interest-based investments
- stocks of companies that have high debt (sometimes referred to as highly leveraged)
- securities of companies in industries that do not adhere to Islamic principles, such as liquor, gambling, pornography, pork, insurance, banks, etc.
- mutual funds or hedge funds that trade securities frequently (have high turnover rates) because frequent trading is seen as gambling by some Islamic scholars

Saturna Capital, adviser to the Amana Funds, employs proprietary screens and an investment process developed in collaboration with Islamic scholars of the Fiqh Council of North America (FCNA), a non-profit organization serving the Muslim community. In addition to the business sector screens listed above, Saturna Capital applies the following financial screens, seeking to eliminate companies with

- greater than five percent of their revenue coming from *haram* sources
- greater than 33 percent total debt as compared to their market capitalization (trailing 12 month average)
- greater than 45 percent accounts receivable as compared to their total assets (trailing 12 month average)

If a company fails the screening process it is considered an unacceptable investment. However, *Halal* investment screening is not always straightforward. When considering whether an investment is *Halal*, it is necessary to look deeply into a company's business activities to discover its core sources of revenue, or how it actually makes its money.

A company's industry sector, or part of the economy to which it belongs, may not always tell you the whole story. A computer software company may write programs used in gambling. A company that publishes children's books may also produce books that are considered pornographic. An agricultural producer might sell its crops exclusively to breweries. On the surface, each of these companies may not appear to be *haram*, but a closer examination reveals otherwise.

Saturna's investment analysts use NEPTUNE® software, developed in-house by Saturna, to screen, grade, and monitor more than 10,000 securities traded worldwide monthly. Securities that receive an "A" grade are subject to further in-depth review prior to purchase.

The *Halal* investment process does not end with a security's purchase. We monitor the securities in the Amana Funds' portfolios for ongoing compliance with *Halal* investing criteria and sell if they fail screens at a later date.

Benefits and Risks of *Halal* Investing

Investing according to Islamic principles can offer many benefits to Muslims and non-Muslims alike. *Halal* investing encourages a disciplined investment process that promotes in-depth security research and monitoring. Generally, the low debt requirements of Islamic screens facilitate a conservative approach that appeals to risk-averse investors.

Halal investing discourages short-term speculation. The low turnover required in *Halal* investment portfolios results in longer planned holding periods and close scrutiny of company financials. Low turnover also minimizes portfolio trading expenses, such as broker commissions, while increasing tax efficiency by avoiding rapid buying and selling of securities that can generate taxable capital gains.

The limitations imposed on investment opportunities by Islamic principles potentially creates risk. For example, among the securities researched monthly by Saturna Capital for the Amana Funds, less than half pass the initial screens necessary to be considered *Halal*. Restricting investment choices to a smaller universe means that a *Halal* portfolio may not be as diversified as other portfolios, which may increase the risk of loss. The returns from various market sectors rise and fall at different times. Islamic principles may limit opportunities to gain when prohibited market sectors, such as financial services, rally.